

# **The legal needs of small businesses**

## **An analysis of small businesses' experience of legal problems, capacity and attitudes**

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## **Key Findings**

### **Business problems decline but are costly**

- The number of legal problems faced by small firms reduced significantly over the last two years reflecting better trading conditions. The most common problems related to trading, employment and taxation. Other businesses were the main source of problems.
- Half of firms reporting a legal issue said it had a negative impact; one-quarter of them reported loss of income and one-fifth reported health related problems. Total annual losses to small firms due to legal problems is estimated at £9.79bn
- Larger small businesses, and businesses with BME and disabled business owners-managers, were most likely to experience problems

### **Limited engagement with legal service providers**

- The large majority of firms had little contact with legal advisers. Less than one in 10 either employed in-house lawyers or had a retainer with an external provider. Over half of firms experiencing a problem tried to resolve it by themselves. When advice was sought, accountants were consulted more often than lawyers
- There was a marked decline in the use of external support providers between 2013 and 2015, reflecting the decline in problems. Use of solicitors in the previous 12 months fell from almost 20% to almost 10%; and accountants from over 60% to just over 49%.

### **Mixed attitudes to legal service providers**

- Only 13% of firms viewed lawyers as cost effective – little improved since the LSB's 2013 survey. Microenterprises were the least likely to view lawyers as affordable
- Almost 50% of respondents strongly agreed or agreed with the statement that they use legal service providers as a last resort to solve business problems compared with 12% who disagreed strongly or disagreed.
- Satisfaction that law and regulation provide a fair trading environment increased from 30% in 2013 to 45% in 2015 – improving economic conditions as well as improvements in the regulatory environment may explain this change.

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## **Executive Summary**

### **1. Aims and Methods**

- This report, commissioned by the LSB, presents new empirical evidence on small businesses' experiences of legal problems and their strategies and actions in dealing with these problems in 2015. It follows on from a baseline study conducted on behalf of the LSB in 2013.
- The new data comprises an online survey conducted by YouGov of 10,528 individuals in small, private sector businesses and not-for-profit organisations, employing fewer than 50 people. The survey was conducted in March 2015.
- The sample included businesses across the full size range from 1 worker to 49, and businesses in all major sectors of the UK economy.
- Results have been weighted to reflect the composition of the UK small business population by size and sector. The business population is skewed towards the small end of the size spectrum; the weightings reflect this, with three quarters of weighted sample firms being 1-person operations. To undertake comparisons, the 2013 survey data have been reweighted according to the same principles.
- The 10,528 sample included 1,463 individuals who were interviewed in 2013, allowing a panel, time-series analysis.

### **2. Legal Capacity**

- Most small businesses (87%) do not have any internal legal capacity, defined in terms of the presence of a qualified lawyer, or a person trained in handling legal issues in-house; or external capacity, defined in terms of ongoing retainer contracts with a legal professional or an HR/employment service.
- Only 5% of firms reported in-house legal capability.
- 8% of firms reported retainers with a legal services provider: external capacity
- Just over 1% of firms reported an HR/Employment retainer
- In addition to retainers, firms also reported using a range of professional service providers in the last 12 months. Most common among these are accountants (used by 43% of firms). Specialist legal services providers were used much less frequently: solicitors (used by 9%); a legal helpline (2%); barristers (1%); and another legal service (less than 1%).

- Against a background of falling incidence of legal problems, there was a marked decline in the use of external support providers between 2013 and 2015, from 72% to 54% overall. Use of solicitors in the previous 12 months fell from almost 20% to almost 10%; and accountants from over 60% to just over 49%.
- The use of retainer contracts is strongly associated with business size. Firms with 10-49 staff were much more likely to report retainers with legal professionals and HR/employment specialists than 1-person firms: 34% compared with 5%.
- The use of external business services varied significantly by size of firm. Larger small firms were more likely to use business support services than micro and one-person businesses. For instance, whereas 38% of firms with 10-49 staff reported using a solicitor, the proportion of one-person firms was only 4%. For barristers, the equivalent figures were 4% and 1%.
- Legal capacity also varies by owner characteristics (ethnicity, disability) and business characteristics (size, family ownership, customer base, sector) and reporting of legal problems.
- External legal capacity was found to increase as firm size grew but then slowed down beyond 29 employees. For internal legal capacity this positive relationship continues until it reaches 47 employees. This shows that legal capacity is not strictly a function of size of business although it does tell us that firms are looking to add legal capacity as they grow. Of course, this is an analysis of the marginal changes in legal capacity and should not be taken to suggest that legal capacity is lower in larger small firms. Indeed, the opposite is the case. Larger small firms are most likely to need legal capacity, be able to afford it and acquire it.

### **3. Experience of Legal Problems**

- Overall, respondents reported around 40,000 problems in the last 12 months. The most common problems were related to trading: almost 20% of firms reported such a problem, followed by employment (6.5%) and then taxation (6.0%).
- Between 2013 and 2015 the average number of problems per firm fell from 21 to 13.
- The sources of problems faced by businesses were mainly other businesses (49%) followed by individual members of the public (18%), government (16%) and employees (10%). The latter were the largest 'internal' legal problem.

- Larger small firms are much more likely to encounter problems. This is not unsurprising given that larger small firms are more likely to engage with a broader range of internal issues and external stakeholders. From this we may induce that as a firm grows it also encounters additional legal problems.
- However, the size – business problem relationship is not simply linear. We estimate that this legal problem for business size relationship peaks at around 28 employees and then diminishes. Whether this means that firms are able to anticipate potential legal problems and avoid them once they have some form of legal advice or capacity is open to further empirical examination.
- The incidence with which legal problems were experienced in a business varied according to owner-manager characteristics. White owner-managers experienced a lower incidence of business problems than Black and minority ethnic (BME) owner-managers, by a probability of nine percentage points. This relationship holds across all types of legal problem. Owner-managers with a disability were also more likely to experience legal problems. Amongst these, those with a severe disability were even more likely to have experienced a problem than those with no disability by 11 percentage points.
- There was sector variation in the reporting of legal problems. Firms in primary, production, construction and wholesale have a higher probability of experiencing a legal problem overall compared with other sectors. Firms experiencing financial problems were also more likely to have legal problems.

#### **4. The Impact of Legal Problems**

- Approximately half of all firms reporting a problem also reported one of the prompted tangible impacts. The most frequently cited impact was loss of income (26%), followed by loss of customer/contract (9%).
- Some respondents reported less of an impact on the enterprise than others. Larger firms were more likely to report no impact as were those firms that served either individual or organisation customers but not both. Firms in primary, construction and transport and communications all report an impact.
- Legal problems may also have implications for the health and well-being of business owners and their staff. One in five respondents reported between one and three prompted health issues as a consequence of a legal problem. Stress-related illnesses were reported by 16% of respondents.

## **5. Addressing Legal Problems**

- The most frequent response to sorting out a problem was for owner-managers to do so on their own. However, in doing so, the most common first response is to look for information and resources on the internet. The evidence suggests that around 20% of those with a legal problem drew upon the legal service profession.
- Face-to-face meetings are the most frequent way of receiving legal services from all providers except patent attorneys and legal helplines. Email and telephone delivery methods were also important for contact with solicitors. Contact with barristers and licensed conveyancers also involved the internet and texting. Hence, although new forms of delivery were important, conventional forms endured.
- Provider reputation (30%), legal specialism (25%) and prior use (24%) were reported as the most important reasons for choosing particular providers above cost concerns. Recommendations from family and friends, accountants and trade bodies were also important.
- One third of respondents reported contacting support providers who were unable to help them. Nine percent of those approaching solicitors said the solicitors were unable to help. This compares with around 8% for accountants. This may not necessarily mean that there is a supply-side gap in legal service provision. For example, less than 4% agreed or agreed strongly that *'Not being able to find a suitable legal services provider when I need one has affected the growth of my business'*. However, it does show that the first point of advice seeking may not necessarily be the final chosen source.
- In one quarter of cases of having a legal problem, respondents reported involvement with legal (or formal) mechanisms as part of the problem or its solution. However, issues were mainly resolved by the parties, either in agreement or by one side acting unilaterally, rather than through legal means or through the involvement of third parties.

## **6. Outcome of Legal Problems**

- The most recent problems were resolved by the parties, either in agreement or by one side acting unilaterally, rather than through legal means or through the involvement of third parties. The profile of responses is very similar to that found in the 2013 Survey.

- The majority of respondents reported outcomes that were completely or mostly in their favour. Again respondents reported only a few differences with the 2013 results

## **7. Attitudes to Risk, Law and Legal Services**

- Respondents were asked a series of questions to ascertain their attitudes to the influence of the law, and of legal professionals, on their business practices and, in particular, with regard to solving specific business problems.
- A markedly larger proportion of owner-managers reported agreement with the statement '*law and regulation provide a fair environment for business to succeed*': 45% in 2015, compared with 30% in 2013. This change in attitude may be related to the improving economic conditions as well as improvements in the regulatory environment.
- Small business owner-managers are generally trusting of the people they work with. The overwhelming majority of respondents (71%) agreed strongly or agreed with the statement that '*when doing business I generally trust the people that I come into contact with*'.
- Small business owner-managers report mixed views regarding the cost-effectiveness of lawyers to resolve legal issues. Almost half of respondents disagreed with the statement that '*Lawyers provide a cost effective means to resolve legal issues*' and only 13% agreed with the statement.
- This may go some way to explaining why owner-managers tend to use formal legal services to solve business problems as a last resort. Almost 50% of respondents strongly agreed or agreed with the statement that they use legal service providers as a last resort to solve business problems compared with 12% who disagreed strongly or disagreed.

## **8. Panel Analysis 2013-2015**

- A subset of businesses participated in both the 2013 and 2015 surveys. Investigating these two subsamples provides some insights into stability and change in the experiences, practices and attitudes during the period. The panel comprises a sample of individuals rather than businesses; adjustments have to be made to the sample in order to increase the likelihood that the data refer to the same firms in 2013 and 2015. The panel comprises firms participating in both surveys and operating in the same sector.
- Experience of problems declined between 2013 and 2015, from 35% to 28%. This is broadly similar to the decreasing incidence found in the 2013 and 2015

survey samples as a whole (although direct comparisons cannot be drawn due to weighting).

- Use of business support providers also declined among the panel sample across the two surveys. Panel sample businesses were more likely to report use of any business support services in 2013 than in 2015 (74% compared to 58%).
- Slightly more panel sample respondents reported one or more of the prompted negative outcomes resulting from their most recent business problem in 2015 than in 2013 (49%, compared to 42%).
- Slightly fewer panel sample firms reported taking action to solve a problem in 2015 (86% compared with 93% in 2013), although slightly more firms reported seeking formal advice to sort out the problem (38% compared with 36%).
- Respondents were asked two attitudes questions in both the 2013 and 2015 surveys. The response profiles were reasonably similar for each across the two surveys, although panel sample firms were more likely to agree with the statement that 'law and regulation provide a fair environment for business to succeed' in 2015 than in 2013 (42% agree or strongly agree, compared with 28% in 2013). These differences were statistically significant.

## **9. Conclusions and Implications**

- Overall, the Report provides statistical results and a depth of analysis that contributes to an understanding of small businesses' experience of legal problems, how they respond to such problems utilising legal services and their experiences and attitudes to legal services.
- The analysis highlights the advantages of disaggregating the small business sector to develop a sound evidence base. It also demonstrates the need to avoid over-generalising because of the variations in experience and needs amongst small firms. Thus, whilst there may be an overall small business experience in terms of legal problems and accessing legal services, this does vary within this group.
- The results show that it is specific types of firms that have higher levels of legal capacity and legal problems. These tend to be larger small firms, those that are BME owned or with an owner-manager who has a disability.
- The relationship between business size and experience of legal problems may be taken to imply that as firms grow they will experience new business problems that require legal advice. The evidence shows that different types of problems

(e.g. trading; employees; intellectual property) are more important according to different sizes of firm.

- Small business owner-managers regard legal services as expensive and such services are not part of their day-to-day business networks or life. Indeed, drawing upon legal services is not normally considered an option unless other previously trusted sources of advice have been used. This may not necessarily indicate that the solutions to problems are sub-optimum. Rather, small businesses try and test various routes to solving business problems and carefully drawing upon legal services may be appropriate given their scarce resources. However, the cost of legal services was a significant barrier to small firms' taking up legal services.
- A number of implications and recommendations are made based on the analysis designed to improve the legal service provision for small firms and their access to the justice system. Reaching micro firms, in particular, is one of the challenges currently facing legal service providers, particularly given the rise in their numbers.
- The research also suggests a need for improved communications between legal service providers and small firms. This may be done through the networks that small firms frequent, such as chambers of commerce, to help break down any misperceptions of legal service providers and generate new links and embed the activities of legal service providers into the world of the small business owner.
- Legal service providers and their representative organisations may wish to consider developing strategic ties with other key organisations and service providers, including BIS and related bodies (such as UKTI); accountants; and universities. There is a potential role for legal service providers in many of the initiatives and activities of other organisations that deal with small firms. Working with these organisations would help promote legal services through their initiatives and activities.

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# 1. Introduction

## 1.1 The Context

The number of small firms in the UK economy has been increasing in the past 20 years. In 2014 there were an estimated 5.2 million private sector firms. The vast majority of firms (99%) are small (employing up to 49 people); these firms contribute 33% of business turnover and 48% of employment: 76% of all enterprises are ‘with no employees’ and only 0.1% employ 250 people or more (BIS, 2014a). Given their small size, firms often turn to utilising external resources as a means of overcoming their limited in-house capacities and capabilities (Bennett and Robson, 1999) and raising their competencies (Teece et al., 1997). This includes the search and acquisition of advice and support, through to help to make strategic and practical decisions (eg. financial, managerial and market knowledge) as well as buying-in specific services (eg. payroll). Under certain economic and business circumstances, such as growth periods or stages in development, small firms are more likely to seek external advice and support (eg Furlan et al., 2014).<sup>1</sup>

This research is set within the broader context of the strategic goals of the LSB: breaking down the regulatory barriers to competition, growth and innovation; and enabling need for legal services to be met more effectively (LSB, 2015). There is evidence to suggest that many of the problems that small firms face are ‘justiciable’ and could be resolved by recourse to the legal system. Hence, access to justice is a crucial factor in creating a supportive environment within which small firms can thrive. However, benchmarking data reported in 2013 found that there may be some unmet legal need amongst small firms. For example, around a half of small firms regard law as important but less than a fifth get legal advice when they have a problem (Plesance and Balmer, 2013). This report provides new results and analyses that contribute to

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<sup>1</sup> In relation to small firms’ use of external professional advice and support, the bulk of research has, hitherto, mainly been on the role of accountants and SMEs. However, the benchmarking study of 2013 for the Legal Services Board (Plesance and Balmer, 2013) provided a baseline for this report and subsequent research on small firms and legal services.

developing a theoretical and evidence base on the legal needs of small firms, their use and attitudes to legal services.

The LSB benchmarking survey (Pleasance and Balmer, 2013) found that only 6% of small firms (with up to 49 employees) had engaged a qualified lawyer or trained person to deal with legal issues, although this rises with size of business. Given that 38% of businesses had experienced one or more legal problem in the previous 12 months and the size of the business population, the predicted scale of legal advice services required by small firms is likely to be substantial. It is crucial, therefore, that the legal services industry is aware of the scale and type of legal issues that small firms encounter, to enable the provision of a fit for purpose service that enables the smooth functioning of enterprise.

## 1.2 Aims and Objectives

This report presents new empirical evidence on small businesses' experiences of legal problems and their strategies and actions in dealing with these problems. The analysis will first examine the use of legal services by small firms and see how these have changed since the earlier benchmarking study; and second, model small firms' use of legal services that will help identify the particular characteristics of firms in relation to the legal problems they face and how these are addressed.

Specifically, the research will provide:

- I. A description of the characteristics of the respondents
- II. An analysis of the incidence of legal problems amongst respondents, the different problem types and their association with individual and business characteristics
- III. An analysis of the use of different support services, by respondent characteristics and by levels of legal capacity
- IV. An analysis of different responses to these legal problems considering both respondent characteristics and attitudes
- V. An analysis of how the pattern of response to legal problems has changed, the drivers of this change, how this change varies by business sector, size and the scale of the change

The survey sample provides a robust dataset that allows a comparison with the 2013 report (Pleasance and Balmer, 2013). Hence, in addition to a cross-sectional analysis of the 2015 survey, the report will compare the results with the 2013 benchmarking survey. To this end, over 1,400 individuals interviewed in 2013 were also interviewed in 2015, allowing a panel analysis.

### 1.3 The Sample of Businesses

The sample on which this analysis is undertaken comprises a survey of 10,528 individuals that own, or manage, independent small firms undertaken in 2015. To our knowledge, this is the largest survey of small firms' interactions with the legal sector. These are defined as having less than 50 employees, including the owner-managers. Overall, the survey data closely correspond to the UK business population but in some sectors, such as 'construction' and other business, public administration and defence, the survey data was under represented or over represented. Hence, the sample is weighted to represent the UK business population as a whole (BIS, 2014a). Table 1.1 shows the distribution of firms by sector and the weighted distribution in the right-hand column. All data tables in the report use the weighted sample in order for the analysis to be representative of the UK small business population. The distribution of the weighted sample shows the concentration of small firms in the personal and business service sectors, and in construction.

**Table 1.1 Sample Businesses by Sector 2015**

Sector	Number of businesses	% of survey sample	% of UK businesses
Primary – agriculture, forestry & fishing	302	2.4	2.9
Production	573	5.6	5.4
Construction	1891	6.9	18.0
Wholesale & retail trade	1063	9.7	10.1
Hotels, catering & leisure	815	5.2	7.7
Transport & communication	1201	12.5	11.4

Finance, insurance & real estate	362	5.5	3.4
Education	515	6.0	4.9
Health	664	5.1	6.3
Consultancy services	1548	11.2	14.7
Not-for-profit organisations	148	5.3	1.4
Other business, public admin, and defence	1446	24.5	13.7
<b>N</b>	<b>10,528</b>	<b>100.0</b>	<b>100.0</b>
Base: All sample.			

Table 1.2 reflects the skewed distribution of the UK business population with the weighted sample having three-quarters of firms with only one worker and 3.9% with 10-49 workers.

**Table 1.2 Sample Businesses by Size 2015**

	Number of Businesses	% of sample
1 worker	7961	75.6
2 workers	821	7.8
3-4 workers	590	5.6
5-9 workers	741	7.0
10-19 workers	214	2.0
20-49 workers	202	1.9
<b>N</b>	<b>10,528</b>	<b>100.0</b>
Base: All sample.		

The weighted sample also shows that over two-thirds of the businesses are sole proprietors and a quarter private limited companies (Table 1.3). This underlines the skewedness of the business population towards micro firms.

**Table 1.3 Legal Status of Business**

	Number of Businesses	% of sample
Sole proprietor/trader	7189	68.3
Private limited company	2558	24.3
Limited partnership	73	0.7
Partnership	444	4.2
Other	264	2.5
<b>N</b>	<b>10,528</b>	<b>100.00</b>

Base: All sample.
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The analysis provides a comparison with the benchmarking survey undertaken in 2013. In order to ensure consistency in methodological approach, the 2013 data has also been weighted to the UK distribution of firms by size and sector using BIS estimates for 2013 (BIS, 2013). Table 1.4 shows the distribution of firms by sector for the 2013 sample and the weighted distribution in the final right-hand column. When the data are weighted for both sector and size, the observed gap between the survey sample and the small business population reported in 1.1 is reduced providing a more representative dataset. It is this data that is used throughout this report in comparative analyses.

**Table 1.4 Sample Businesses by Sector 2013**

Sector	Number of businesses in sample	% of sample	% of all UK businesses
Primary	300	2.6	3.1
Production	492	5.6	5.2
Construction	1788	7.6	18.7
Wholesale & retail trade	1006	10.1	10.5
Hotels, catering & leisure	735	6.4	7.7
Transport & communication	1098	13.9	11.5
Finance, insurance & real estate	329	6.7	3.4
Education	479	5.3	5.0
Health	593	4.3	6.2
Consultancy services	1308	12.4	13.7
Not-for-profit organisations	152	4.3	1.6
Other business, public admin, and defence	1269	20.9	13.3
<b>N</b>	<b>9,548</b>	<b>100</b>	<b>100</b>
Base: All sample.			

Table 1.5 provides a snapshot of the main characteristics of the businesses in the 2015 survey. These characteristics are *prima facie* expected to influence the legal capacity of businesses, the frequency and type of legal problems they face and to shape their responses to handling legal problems. These characteristics will be utilised in the

multivariate modelling presented later in the report. The advantage of the modelling is that it allows a focus on specific relationships between variables within the data, such as between respondents with a disability and their use of legal services whilst controlling for other characteristics (See Appendix One for a more full discussion of modelling methods and results).

**Table 1.5: Sample Characteristics 2015**

	<i>Weighted N (%)</i>	<i>Unweighted N (%)</i>
<b>Business Size</b>		
1 worker	75.6	49.1
2- 9 workers	20.4	36.0
10-49 workers	3.9	15.1
<b>Ethnic Group</b>		
White British/other White	93.5	87.6
Ethnic minority/mixed	3.7	9.8
Prefer not to say	2.8	2.6
<b>Disability</b>		
Yes, limited a lot	4.4	4.6
Yes, limited a little	19.8	18.3
No	75.8	77.1
<b>Family Ownership</b>		
Majority owned by members of the same family	66.6	57.7
<b>Age of Business</b>		
Up to 3 years	19.8	16.9
3-6 years	18.6	17.0
6-10 years	14.4	13.2
10-25 years	29.8	31.8
25 years plus	15.0	17.8
No data	2.5	3.3
<b>Expected Turnover in Current Year</b>		
£1m +	2.5	7.2
£500k-£1m	2.4	5.2
£250-500k	3.4	5.9
£100-250k	6.6	8.6
£50-100k	12.6	12.2
Less than £50k	54.5	41.3
First year of trading	5.9	4.7
Don't know	12.0	14.8
<b>Expect to make a profit in current year</b>		
Yes	67.9	67.7
No	14.4	15.0
Don't know	17.7	17.3
<b>Customer Base</b>		
Individuals only	42.2	38.0
Organisations only	38.3	42.0
Individuals and organisations	19.4	20.0
<b>N</b>	<b>10,528</b>	<b>10,528</b>

Note: Columns do not sum to 100% due to rounding.
Base: All sample.

## **2. Legal Capacity and Use of Legal Services**

### **2.1 Introduction**

This Chapter examines the extent and type of legal capacity utilised by the surveyed businesses. From the earlier benchmarking study a number of differences are expected in relation to the breadth and depth of legal capacity. These vary according to owner-manager and business characteristics. Firms have a number of options regarding their legal capacity: from buying-in services on an ad-hoc basis, through to having an external legal retainer; and an in-house expert. This Chapter presents some baseline evidence. It then presents a multivariate analysis in which particular characteristics of firms that are associated with different types of capacity are identified.

### **2.2 The Sources of Legal Capacity**

Given small firms' resource constraints, it is expected that their in-house legal expertise will be minimal. The results from both the 2013 and 2015 surveys support this expectation with around 5% of firms having access to a qualified lawyer or a person trained in handling legal issues in-house (Table 2.1). The data suggests a one percentage decline in internal legal capacity since 2013 (from 6% to 5%), although this is not statistically significant. The main areas of internal legal expertise included contracts and employment.<sup>2</sup>

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<sup>2</sup> This reflects earlier research that found smaller firms to be more likely to have wages and breaches of contract cases brought against them than larger organisations (Saridakis et al., 2008).

**Table 2.1 Internal Legal Capacity**

	2013 (%)	2015 (%)
The firm has a qualified lawyer or a person trained in handling legal issues in-house	5.8	4.9
<i>Areas of specialism:</i>		
• Contract	2.3	1.6
• Employment	1.4	1.3
• Property	1.3	0.9
• Business ownership	1.3	0.9
• Tax	1.1	0.9
• Intellectual property	0.7	0.6
• Crime	0.8	0.5
• Personal injury	0.6	0.5
• Regulation/competition	0.5	0.4
• Other specialism(s)	1.2	1.3
Don't know	0.3	0.3
<b>N</b>	<b>9,548</b>	<b>10,528</b>
Base: All sample. Not statistically significant		

Respondents were also asked which, if any, of a range of independent professional services the business had made use of in the last 12 months (Table 2.2).<sup>3</sup> Respondents reported using all of the prompted sources. Accountants are, by a considerable margin, the most commonly used external services provider in 2015, followed by solicitors and tax advisers. This is confirmed in numerous other studies (eg. Bennett and Robson, 1999; 2004; Blackburn et al., 2010; Gooderham et al., 2004) and most probably reflects the diversification of business services provided by accountants (eg Jarvis and Rigby, 2012; Sarens et al., 2015).

The results show that there is also a marked decline across the board in the use of external support providers by small firms between the two surveys in 2013 and 2015 (Table 2.2). This may reflect the decline in the proportion of sample firms reporting problems, and in the absolute number of problems reported. It may also reflect

<sup>3</sup> Respondents were asked a separate question about retainers with legal professionals and with HR/employment specialists.



improving trading conditions in the UK economy. The majority of the differences between the surveys shown in Table 2.2 are statistically significant.<sup>4</sup>

**Table 2.2 Use of Business Support Services in Past Year**

	2013 (%)	2015 (%)
<i>Any external provider used***</i>	72.3	54.5
Accountant***	61.1	43.4
Solicitors' firm***	18.8	8.8
Tax adviser***	26.5	8.6
Financial adviser***	22.7	8.4
Citizens Advice Bureau or similar independent advice agency***	7.8	3.2
Other business support service***	12.7	2.6
HR/Employment service**	6.2	2.5
A legal helpline***	7.6	2.3
Debt collection/recovery service*	4.8	1.8
Barrister	3.6	1.1
Patent/trademark attorney/agent	3.4	1.0
Licensed conveyancer	3.6	0.8
Another legal service	5.4	0.4
<b>N</b>	<b>9,548</b>	<b>10,528</b>
Note: In the 2013 survey, respondents were asked if they had contacted sources formally and informally; both are included. In 2015, the formal/informal distinction was dropped.		
Base: All sample.		
*** Percentages Significantly different at 99%		
** Percentages significantly different at 95%		
* Percentages significantly different at 90%		

## 2.3 Legal Capacity and Size of Firm

The use of external business services varied significantly by size of firm (Table 2.3). Firms with one worker were much less likely to use business support services than larger businesses. Specifically, firms employing 10-49 employees were much more likely to use a solicitor, suggesting that a significant size threshold is met as firms grow.

<sup>4</sup> The reported levels of significance are based on the results of chi square tests. Where no asterisk is indicated the association is not significant. Where expected values fall below 5 in any cell, these are also not reported.

Overall, less than a half of firms with one worker used some form of external independent professional service compared with almost 80% of firms employing 2-9 and 87% of firms with 10-49 employees. This suggests that as firms grow, they rely on external sources for professional advice and support as well as develop their internal legal capacity.

**Table 2.3 Use of Business Support Services by Size of Firm 2015**

	<i>Size of firm</i>			
	<i>1 worker (%)</i>	<i>2-9 (%)</i>	<i>10-49 (%)</i>	<i>All (%)</i>
<i>Any external providers used***</i>	46.5	77.9	86.5	54.5
Accountant***	36.0	66.5	65.6	43.4
Solicitors' firm***	4.4	19.1	38.0	8.8
Tax adviser***	6.3	14.5	21.0	8.6
Financial adviser***	6.3	13.9	18.8	8.4
Citizens Advice Bureau or similar independent advice agency**	3.0	3.7	5.1	3.2
Other business support service	2.5	2.6	3.6	2.6
HR/Employment service***	0.8	4.9	23.8	2.5
A legal helpline***	1.5	4.4	7.2	2.3
Debt collection/recovery service***	0.9	4.1	8.4	1.8
Barrister***	0.7	1.9	3.8	1.1
Licensed conveyancer***	0.4	2.3	2.6	0.8
Patent/trademark attorney/agent***	0.6	2.1	4.1	1.0
Another legal service	0.4	0.6	0.7	0.4
<b>N</b>	<b>7,961</b>	<b>2,151</b>	<b>415</b>	<b>10,527</b>
Base: All sample.				
*** Percentages significantly different at 99%				
** Percentages significantly different at 95%				

For some businesses, having an ongoing contract with a legal service or HR/employment service provider presents a more appropriate service relationship. In both 2013 and 2015, almost one in 10 firms had a legal service retainer and 1% an HR/employment service retainer (Table 2.4).

**Table 2.4 Retainer Contracts Legal Services and HR/Employment Service 2015**

<i>Does firm have an on-going contract in relation to:</i>	<i>1 worker (%)</i>	<i>2-9 (%)</i>	<i>10-49 (%)</i>	<i>All (%)</i>
Legal service***	5.3	15.2	34.1	8.5
HR/Employment service~	n/a	2.7	15.6	1.2
<b>N</b>	<b>7,961</b>	<b>2,151</b>	<b>416</b>	<b>10,528</b>
Note: ~Question only asked of firms with employees: 1-worker businesses not asked.				
Base: All sample.				
*** Percentages significantly different at 99%				
~ Chi-Square test minimum condition of at least 5 observations in each cell is not met.				

Table 2.4 shows that there is a clear positive relationship between size of firm and having retainer services: 34% of firms with 10-49 employees had a legal service retainer compared with only 5% of firms with one worker. A similar relationship with business size held for the HR/employment retainer, confirming previous research on the association between HR capacity and firm size (Harris, 2000; Storey et al., 2010).

**Table 2.5 Legal Capacity by Size of Firm**

<i>Legal Capacity</i>	<i>1 worker (%)</i>	<i>2-9 (%)</i>	<i>10-49 (%)</i>	<i>All (%)</i>
None**	91.2	78.4	54.3	87.2
Internal Only*	3.5	5.1	5.5	3.9
Internal plus external***	0.2	2.5	7.7	1.0
External only**	5.1	14.0	32.5	8.0
<b>N</b>	<b>7961</b>	<b>2151</b>	<b>416</b>	<b>10,528</b>
Note: 'External capacity' refers to retainer contracts only, with <i>either</i> professional legal services providers <i>or</i> HR/employment specialists <i>or</i> both.				
Base: All sample.				
*** Percentages significantly different at 99%				
** Percentages significantly different at 95%				
* Percentages significantly different at 90%				

It is possible to combine the questions on internal and external sources of legal expertise to assess overall legal capacity. For these purposes, external legal capacity is defined as having a retainer with either a legal service or HR/employment service. The

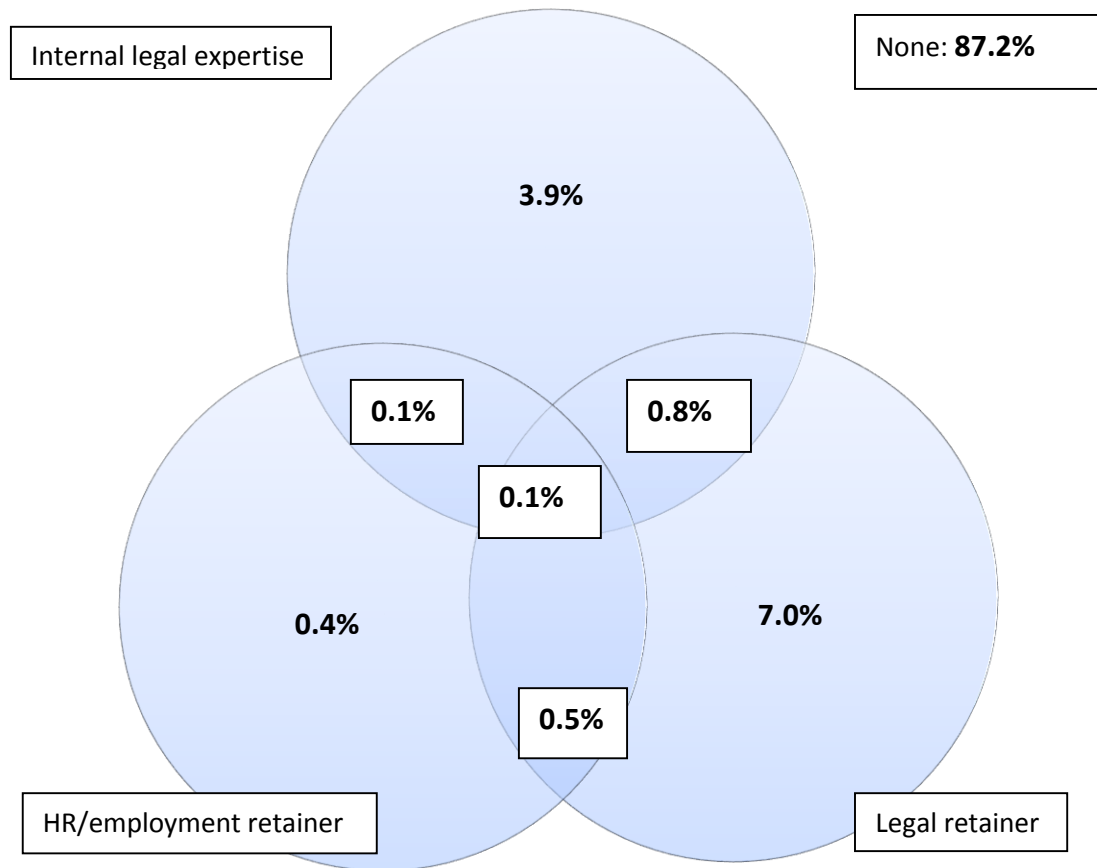
data illustrates the positive statistically significant relationship between legal capacity and size of enterprise. Firms employing one worker were much more likely to have no legal capacity than larger firms. The larger the firm, the more likely it is to have some internal and/or external legal capacity although external capacity increases at a higher rate.

## 2.4 Depth of Legal Capacity

Figure 2.1 provides an overview of the various sources of legal and HR/employment expertise for firms and shows how some firms have a greater depth of capacity than others. The Figure includes only the retainer contracts with professional legal services providers and HR/employment specialists – but not ad hoc use of external business support services.

The vast majority of firms (87%) possess no internal or external capacity (Figure 2.1). Very few firms use retainer contracts with professional services providers, although firms with some legal capacity were more likely to draw upon this externally rather than in-house. Only a very small minority (0.1% of sample firms) utilise all sources of legal capacity and have an HR/employment retainer.

**Figure 2.1 Interaction of legal expertise, retainer agreements for legal services and HR/Employment Services**



Base: All sample.

## 2.5 How does legal capacity vary by owner-manager and firm characteristics? A Multivariate analysis

A multivariate analysis was undertaken to identify how the characteristics of firms and respondents alter the probability of a firm having legal capacity. Internal legal capacity is defined as having any in-house staff and external capacity as having a legal or employment/HR retainer.

The advantage of this approach over the analysis presented in Figure 2.1 is that it helps identify the specific direction and strength of relationships between key

variables whilst controlling for a wide range of other characteristics. In order to provide an interpretation of the results, we calculate the marginal effects (MEs). This provides an estimate, in terms of percentage points, of how a one unit change in an independent variable affects the dependent variable.

The results in terms of the use of external capacity reveal significant statistical variations within the sample, as shown in Figure 2.2. Enterprises run by white respondents have a *lower* probability of using external legal capacity by 4.5 percentage points (ME -0.045), than Black and minority ethnic (BME) respondents.<sup>5</sup> There is also a size dimension to the use of legal services. Firms employing 10 – 49 workers are 11 percentage points more likely to have external capacity than those with 2 – 9 employees. The characteristics of respondents also appeared to be related to the type of legal services used. Those respondents with a disability were 7 percentage points more likely to have external capacity than those without a disability.<sup>6</sup> Legal form of enterprise is also important: private limited companies were also more likely to have external capacity.

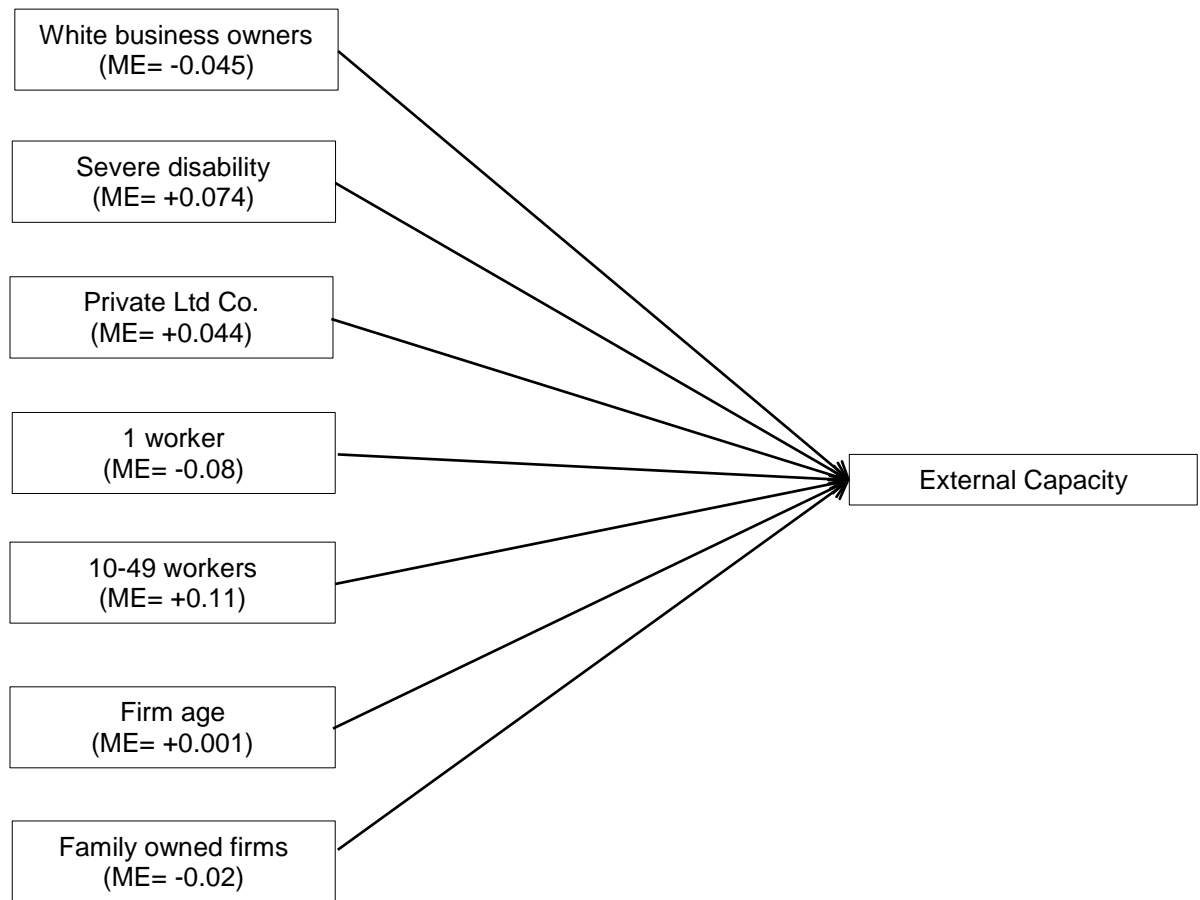
In addition to indicating the size of the probability differences, the analysis shown in Figure 2.2 also indicates the direction of a relationship (positive or negative between two variables). The results also contribute to the wider analysis and understanding of the variation in legal capabilities and problems between different types of firm and respondent characteristics across the sample.

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<sup>5</sup> BME respondents are those in the survey questionnaire who classified their ethnic group other than 'White British' or 'Any other white background'.

<sup>6</sup> Disability is defined as having a long-standing illness, disability or infirmity. If the respondent answered yes, *limited a lot*, this is classified as severe disability; if the answer is yes, *limited a little*, this is classified as mild disability. See question 61 in Appendix Two.

**Figure 2.2 Influences on external capacity in small firms<sup>7</sup> (n=9517)**



The probability of family-owned enterprises having legal capacity, external or especially internal, was lower than non-family firms (ME -0.02 and ME -0.024 respectively). This may be surprising given the additional challenges family firms may encounter, such as in relation to business succession and employment matters (Reary et al., 2013; Sharma et al., 2012). On the other hand, family firms are shown to be particularly resistant to seeking external advice (see: Begin and Fayolle, 2014). Hence, they may try to resolve their business problems without having to resort to employing

<sup>7</sup> The Figures only show those associations where the marginal effects (MEs) are statistically significant (ie where  $p \leq 0.10$ ). In interpreting the results, changes in the probability between different characteristics can be derived. For example, in Figure 2.2 a ME of -0.08 for one worker means that firms with one worker are 8 percentage points less likely to report external capacity than those employing 2-9 workers. Detailed results on which these figures are derived can be found in Appendix One, Table A1.

the services of a legal professional, through informal discussions within the family and drawing upon their own networks and social capital (Strike, 2013).

Figure 2.3 shows the statistically significant relations between a series of respondent and business characteristics and existence of internal capacity. First, the model shows a larger number of statistically significant relations than external capacity. Second, again, respondent characteristics appear influential in terms of capacity: white respondents are *less* likely to have internal legal capacity by 5 percentage points, whereas those with a disability are more likely to have internal capacity (5% points probability more likely). The type of customer also appears to have an effect on scale and type of capacity. Firms serving individuals or organisations *only* as customers were *less* likely to have internal capacity than those with a mixed customer base.

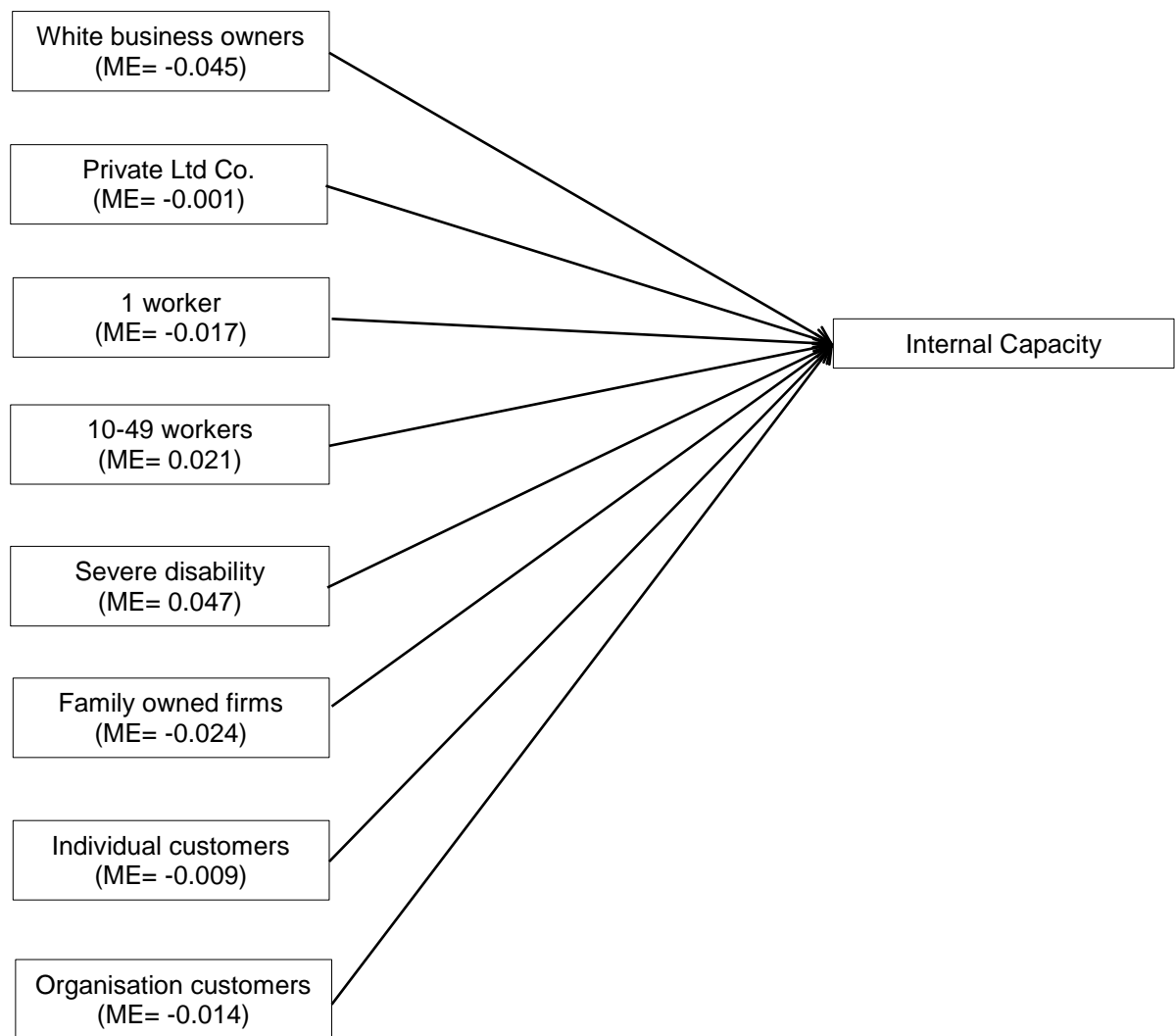
The analysis also shows a slightly lower than average internal capacity for enterprises in most business sectors.<sup>8</sup> The marginal effects were, however, small ranging between 4 percentage points (ME -0.042) in wholesale and retail and 1 percentage point ( - 0.014) in not-for-profit organisations. The former underlines the lower need for legal capacity for those serving individual customers. When external capacity is examined, finance, education, health and not-for-profit all show small positive marginal effects, suggesting that enterprises in these sectors are more likely to have a legal or HR/employment retainer.

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<sup>8</sup> This is in comparison with the base category (Other Business and Public Administration). See Appendix One, Table A1 for full results.



**Figure 2.3 Influences on internal capacity in small firms (N= 9767)**



In seeking to explain the underlying reasons for these results, it is useful to understand the motivations of business owners and managers in small firms to utilise legal services. One key finding is that the demand for legal services is driven by a business problem. These problems may be associated with the life-cycle of the enterprise, such as at start-up (see Ibrahim, 2012), transfer (Battisti et al., 2015), or a result of specific problem, such as in relation to employees (Kitching, 2015).

The analysis shows a strong association with the existence of legal problems and possessing internal legal capacity. Hence, those firms with a legal problem had a higher probability of internal legal capacity. This relationship also held true across all

types of legal problems, with the exception of regulation. A positive relationship also existed with external capacity and some legal problems (trading, employees, premises, intellectual property and structural problems).

Although the direction of causality cannot be observed in the data analysis, it suggests that the demand for legal capacity is *derived* from the need to tackle legal problems. One possible explanation for this general relationship is that vulnerability to legal problems generates a demand for legal capacity over and above ad-hoc advice and support. For example, firms employing 10-49 people are 11 percentage points more likely to have external capacity than those employing 2-9 people (Figure 2.3). Hence, the probability of having internal or external legal capacity increases with size of firm, as does having both sources. Certainly, this argument fits with the broader discussion that the use of external sources of advice and support is ‘problem driven’. For example, research has found that small firms tended to use external advisers and support for transactional purposes, that is helping deal with the day-to-day challenges of running the firm, rather than strategic purposes (Battisti et al., 2015; BMG and CEEDR, 2011).

## 2.6 Legal Capacity and Firm-Size Turning Points

The analysis above shows a general, positive relationship between firm size and legal capacity: firms with one worker were less likely to have internal or external legal capacity than those with 2-9 employees, who were in turn less likely to have legal capacity than the 10-49 size-band. Thus it could be argued that the larger size-band is rather broad and masks differences in capacity within it. Further we estimate the relationship between size of enterprise and marginal changes in legal capacity. This shows how legal capacity grows with enterprise size.<sup>9</sup>

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<sup>9</sup> See Appendix Four for further details and plots of the relationship between size and legal capacity.

**Table 2.6 Size of Enterprise and Legal Capacity**

Capacity	Employment Size
External	29
Internal	37
Base = 9767	

The estimates in Table 2.6 show that a firm will continue to increase its legal capacity until reaching a size threshold at which the marginal increases in legal capacity then slows down. Up to this size, firms are increasing their legal capacity with size of firm. The first threshold is at around 29 employees for external legal capacity growth. For firms to take on their own internal legal specialist, however, the estimated employment size threshold is estimated to be around 37 employees beyond which it then slows down.

The data itself does not allow us to say *why* these thresholds occur at these points because questions were not asked regarding the specific reasons for take-up. However, it could be argued that firms are building up their legal capacity based on the demands made upon them by internal and external problems. They may also reflect the resource capabilities of the enterprise: larger firms are more likely to be able to afford on-going legal expertise. The lower cost of an external resource, in the form of a retainer rather than in-house expertise, most probably explains the lower size threshold for external capacity. Having an external retainer is less expensive than an in-house expert. On the other hand, as the firm grows having an in-house expert is more likely to become cost effective. These results, therefore, suggest that there is a minimum efficient scale for firms to use external or internal legal services. These results fit with the literature on small firms regarding organisational changes and growth in the small firm (Phelps et al, 2007). However, care should be taken given that these are estimates of size-thresholds for the sample as a whole and not all firms follow the same growth trajectory or path. Other factors such as family business ownership and customer base, for example, are found to be influential in this process.

### **3. Experience of Legal Problems**

#### **3.1 Introduction**

In this section we examine the experience of problems faced by small firms that may be considered as having a legal context or implications. Respondents were invited to define a problem as an issue that diverted or distracted you or anybody else within your business, in a significant way, from everyday work activities or responsibilities. Only problems that started within the last 12 months, or problems that started longer than 12 months ago but were still on-going at the time of interview, are included. The advantage of this is that it reduces the possibility of recall error. Respondents were asked to include only problems faced by the business, not those faced in a personal capacity. Respondents were prompted whether they had experienced one or more of 85 significant problems across several different categories (trading, tax, employment, premises, finance/debt, intellectual property, licensing/regulation, structure). So, potentially, respondents could report zero to 85 separate types of problem. Respondents were also asked how many of each type of problem they had experienced. This Chapter examines the results from the survey, including comparisons with 2013, and builds a profile of those firms that are more vulnerable to legal problems.

#### **3.2 Number and Types of Legal Problems**

A further way of examining legal problems is their reported frequency and types of problems that are justiciable – those that could potentially be resolved through legal process. The survey results show a drop in both the percentage of businesses reporting a legal problem and the total number of legal problems experienced. Overall, respondents reported 39,324 problems over the past 12 months. This is a reduction in number of almost half from 2013. Slightly less than a third (29%) of respondents reported one or more problems in the past 12 months, compared with 37% in the 2013 Survey.

**Table 3.1 Mean Number of Problems Per Business**

<i>Cut-off problems at.....</i>	<i>2013</i>	<i>2015</i>
Up to 99 problems	5.82 (n=3,447)	3.76 (n=3,011)
Up to 499	8.11 (n=3,485)	6.81 (n=3,037)
Up to 999	9.42 (n=3,492)	7.39 (n=3,040)
Up to 1,999	12.27 (n=3,501)	10.34 (n=3,046)
Up to 3,999	14.54 (n=3,504)	11.81 (n=3,048)
No cut-off point	21.02 (n=3,507)	12.98 (n=3,049)
Note: data are provided, excluding outliers beyond each cut-off point. Ns given for cases left in sample for each cut-off point.		
Sample: Business reporting problems in the last 12 months.		

In 2015, the mean average number of reported problems was 13.0 (final row in Table 3.1). This compares with the mean average of 21 in 2013. Most respondents (84%) in 2015 reported fewer than 10 problems but the average is raised by a small minority reporting a very large number of problems: 1.2% of those experiencing a problem reported more than 100 problems, and 0.3% reported more than 1,000 problems (the highest being 4,005 problems).

The small number of outlier cases does affect the average (mean) number of problems per business. This is evident in the difference when no cut-off point is used, compared with the various cut-offs shown in Table 3.1. If we impose an upper cut-off of 99 problems in total per firm, the mean number of problems per business falls, for example, to 3.76 in 2015 and 5.82 in 2013; and 7.39 in 2015 and 9.42 in 2013 for a cut-off of 999 reported problems. However, for each level of cut-off – at 100, 500, 1,000, 2,000 and 4,000 problems reported – the average number of problems per business reported is higher in 2013 than in 2015. Thus, whatever the cut-off the results confirm the fall in reported problems between 2013 and 2015. In all cases, the number of reported problems has fallen in 2015 compared with 2013. This finding may be a reflection of the overall improvement in the economy and experiences of small firms

within it. The BIS annual survey of SMEs for example, reported more positive sales and profit performance in 2014, compared with 2015 (BIS, 2015a); and new company insolvencies have continued to decline since 2013 (Insolvency Service, 2015)

In interpreting the results, we must remember that the definition of a problem is highly subjective. Respondents might respond to the question asked in very different ways. For instance, a business owner might define a problem with late payment with a customer as a single problem, as a multiple problem where it persists over time or, possibly, as no problem at all, where it is customary practice for customers to pay several days in excess of contractual or nominally agreed terms. It is reasonable to assume that this will account for some of the fall in the volume of overall problems reported as well as the underlying drop in the incidence of any problem.

The survey also suggests significant changes in the frequency of different problem types. The types of problems and their frequency are shown in Table 3.2. Clearly, trading, taxation and employees are the source of most problems in both years. In 2013, intellectual property, regulation and business structure were also prominent but have diminished in importance in 2015.

**Table 3.2 Number and percentage of problems experienced in Last 12 Months**

<i>Type of problem</i>	<i>% Number of problems reported, 2013 ***</i>	<i>% Number of problems reported, 2015 ***</i>
Trading	33.9	37.5
Tax	10.3	22.0
Employees	11.3	14.5
Intellectual property	9.26	8.8
Business premises	1.0	7.1
Regulation	11.7	4.5
Structure	10.6	2.8
Finance/debt	7.0	1.1
Other problems	4.9	1.8
<b>N</b>	<b>73,735</b>	<b>39,588</b>
Average (Mean) Number	21.3	10.0
Base: All sample. There is a significant relationship between the number of problems reported across the years.		
*** Percentages statistically significantly different at 99% for number of problems overall.		

A further way of examining legal problems is through the type of problem. Business owners' experiences of specific problems across the two survey periods are shown in Table 3.3. This further unpacks the general finding that a higher percentage of firms reported experiencing *any* problem in 2013 than in 2015. This pattern of declining experience between 2013 and 2015 is mirrored for each of the nine sub-categories of problem (trading, tax, intellectual property etc) and for most of the 85 prompted individual problems. The most common problems were related to trading: almost one in five firms reported such a problem in 2015, lower than in 2013 and the difference is found to be statistically different.

**Table 3.3 Experience of Problems**

	2013 (% of firms reporting)	2015 (% of firms reporting)
<b>Trading</b>		
<b>ANY TRADING PROBLEM ***</b>	24.3	19.0
GOODS OR SERVICES PROVIDED TO YOUR CUSTOMERS: Not as described /not of satisfactory quality/fit for purpose	3.2	2.5
GOODS OR SERVICES PROVIDED TO YOUR CUSTOMERS: Unacceptably late delivery	3.0	2.1
GOODS OR SERVICES PROVIDED TO YOUR CUSTOMERS: Unacceptably late or non-/partial-payment	6.2	5.3
GOODS OR SERVICES PROVIDED TO YOUR CUSTOMERS: Distance selling consumer rights	1.2	1.0
GOODS OR SERVICES PROVIDED TO YOUR CUSTOMERS: Other contract problems or disputes	1.9	1.5
GOODS OR SERVICES PURCHASED BY YOUR BUSINESS: Not as described /not of satisfactory quality/fit for purpose	8.1	6.1
GOODS OR SERVICES PURCHASED BY YOUR BUSINESS: Unacceptably late delivery	5.8	4.5
GOODS OR SERVICES PURCHASED BY YOUR BUSINESS: Unacceptably late or non-/partial-payment	3.1	2.2
GOODS OR SERVICES PURCHASED BY YOUR BUSINESS: Other contract problems or disputes	2.1	1.4
GOODS OR SERVICES PURCHASED BY YOUR BUSINESS: Supplier insolvent	1.0	0.5
Fraudulent or wrongful trading	1.6	0.8
Unfair operation of a public tender	1.2	0.5
Legal/regulatory issues relating to international trading	2.0	1.1
<b>Tax</b>		
<b>ANY TAX PROBLEM</b>	8.2	6.0
Liability for tax / amount of tax owed	5.0	3.6
Errors in your business tax return	2.6	1.6
Failure to maintain appropriate records (for tax purposes)	1.3	0.8
Failure to register/report changes when required	0.8	0.4
International taxation	0.9	0.6

<b>Employment</b>		
<b>ANY EMPLOYMENT PROBLEM</b>	7.9	6.5
Staff misconduct	2.5	2.0
Dismissal (or threat of dismissal) of staff	2.1	1.5
Making staff redundant	1.9	1.1
Content or exercise of parental rights (including maternity) leave/pay or flexible working requests	0.7	0.5
Payment of wages/pension	1.6	1.5
Working conditions	1.1	0.8
Employee injury at work	0.7	0.7
Other employment contract issues	1.5	1.0
Adjustments to jobs/workplace for disabled workers	0.3	0.2
Complaints/grievances made by employees/job applicants	0.5	0.6
Employment of non-EU nationals	0.3	0.2
<b>Business Premises</b>		
<b>ANY PREMISES PROBLEM</b>	7.0	4.9
RENTED/LEASED BUSINESS PREMISES: Rent arrears	1.7	0.9
RENTED/LEASED BUSINESS PREMISES: Eviction/threat of eviction	0.7	0.5
RENTED/LEASED BUSINESS PREMISES: Repairs/maintenance or provision of services by landlord	2.0	1.3
RENTED/LEASED BUSINESS PREMISES: Terms of rental agreement/lease	1.6	1.1
RENTED/LEASED BUSINESS PREMISES: Boundaries/rights of way	0.6	0.4
RENTED/LEASED BUSINESS PREMISES: Recovery of rental deposit	0.4	0.1
OWNED BUSINESS PREMISES: Mortgage arrears	0.7	0.4
OWNED BUSINESS PREMISES: Repossession/threat of repossession	0.5	0.2
OWNED BUSINESS PREMISES: Repairs/maintenance of communal areas	1.0	0.9
OWNED BUSINESS PREMISES: Boundaries/rights of way	0.6	0.5
OWNED BUSINESS PREMISES: Planning permission	1.3	0.7
OWNED BUSINESS PREMISES: Conveyancing	0.4	0.2
OWNED BUSINESS PREMISES: Squatters	0.2	0.1
NOT APPLICABLE – NO PREMISES **	44.6	46.8
<b>Debt/finance</b>		
<b>ANY DEBT PROBLEM</b>	3.5	2.5
Unable to pay creditors	3.5	2.5
Insolvency	0.6	0.5
Bankruptcy	0.3	0.2
Receivership	0.2	0.2
Administration	0.2	0.2
Winding up order	0.2	0.1
Individual voluntary arrangement	0.2	0.1
Company voluntary arrangement	0.1	<0.1
Debt relief order	0.1	0.1
Partnership voluntary agreements	<0.1	<0.1
<b>Intellectual Property</b>		
<b>ANY IP PROBLEM</b>	4.3	2.9
INFRINGEMENT OF YOUR BUSINESS' INTELLECTUAL PROPERTY: Trademarks	1.1	0.7
INFRINGEMENT OF YOUR BUSINESS' INTELLECTUAL PROPERTY: Copyright	1.9	1.3



INFRINGEMENT OF YOUR BUSINESS' INTELLECTUAL PROPERTY: Design right/registered design	0.8	0.5
INFRINGEMENT OF YOUR BUSINESS' INTELLECTUAL PROPERTY: Database rights	0.3	0.4
INFRINGEMENT OF YOUR BUSINESS' INTELLECTUAL PROPERTY: Patents	0.3	0.2
INFRINGEMENT OF YOUR BUSINESS' INTELLECTUAL PROPERTY: Disclosure of trade secrets	0.4	0.1
INFRINGEMENT OF INTELLECTUAL PROPERTY BY YOUR BUSINESS: Trademarks	0.6	0.3
INFRINGEMENT OF INTELLECTUAL PROPERTY BY YOUR BUSINESS: Copyright	0.8	0.5
INFRINGEMENT OF INTELLECTUAL PROPERTY BY YOUR BUSINESS: Design right/registered design	0.3	0.3
INFRINGEMENT OF INTELLECTUAL PROPERTY BY YOUR BUSINESS: Database rights	0.3	0.1
INFRINGEMENT OF INTELLECTUAL PROPERTY BY YOUR BUSINESS: Patents	0.1	0.1
INFRINGEMENT OF INTELLECTUAL PROPERTY BY YOUR BUSINESS: Unlawful obtaining of trade secrets	0.2	0.1
<b>Regulation</b>		
<b>ANY REGULATION PROBLEM</b>	<b>6.2</b>	<b>5.4</b>
Mandatory licenses/permits/accreditation	1.1	1.1
Product safety	0.7	0.5
Other health and safety	1.2	1.2
Data protection	1.0	0.7
Import/export regulation	0.6	0.6
Mandatory insurance	0.8	0.8
Filing/content of annual company accounts	1.0	0.5
Need for/outcome of audit	0.3	0.2
Other government regulation	1.3	1.2
Advertising standards	0.3	0.2
<b>Structure</b>		
<b>ANY STRUCTURE PROBLEM</b>	<b>4.6</b>	<b>3.6</b>
Technicalities of business start up	1.4	1.1
Change of legal status	0.6	0.4
Break-up of partnership	0.8	0.7
Partnership/shareholder disputes	0.7	0.6
Merger	0.3	0.3
Take-over of another business	0.5	0.4
Sale of business	0.8	0.5
Joint venture	0.6	0.4
<b>Other Problem Type</b>		
<b>ANY OTHER PROBLEM</b>	<b>2.7</b>	<b>1.7</b>
Defamation	1.0	0.7
Incorrect information held by a credit reporting agency leading to the refusal of credit	1.3	0.6
Mismanagement of business money/investments by financial service	0.7	0.5
<b>N</b>	<b>9,548</b>	<b>10,528</b>
Base: All sample.		
*** Percentages Significantly different at 99%		

Employment was the second most important legal problem in the sample (6.5% of all firms). Staff misconduct followed by dismissal and payment of wages/pension were the most frequently cited legal problems in the employment category. These findings are confirmed in the literature. Previous research has shown that, compared with larger organisations, small firms tend to pay lower wages and have informal arrangements for pay setting (Forth et al., 2006: Table 6.2) and have a higher incidence of wages and breach of contract related cases brought against them (Saridakis et al., 2008).

Taxation presented the third most frequently cited problem (6%), less than found in the 2013 survey (8%). The significance of taxation as a problem and its downward trend is confirmed elsewhere (BIS, 2015a: Table 8.1). Within the taxation category, liability for tax/amount of tax owed was the most frequent (3.6% of all firms).

Problems related to regulation were cited by 5.4% of firms. Although regulatory legal problems spanned a variety of issues and some appeared sector-specific, health and safety and licences/permits/accreditations were amongst the most prevalent. These results are also confirmed elsewhere (BIS, 2015a: Table 8.5).

Problems related to business structure were mentioned by 3.6% of all firms. These included the technicalities of business start-up (1.1%) and the break-up of the business partnership (0.7%). Starting a business, or its dissolution or transfer, involves addressing a range of legal issues that most owner-managers have not previously encountered (eg. Marcum and Blair, 2011; Blair and Marcum, 2015).

Problems related to business premises were reported by 4.9% of firms, a figure lower than the 7% reported in 2013. The most frequent problems in this category included repairs/maintenance or provision of services by landlords (1.3%) and repairs/maintenance of communal areas for owned premises (0.9%). Intellectual

property legal problems were reported by 2.9% of all firms. Within this category infringement of copyright (1.3%) was the most important. Legal problems related to debt and particularly the inability to pay creditors was reported by 2.5% of all firms. Other legal problems included defamation (0.7%) and incorrect information by a credit agency leading to a refund of credit (0.5% of all firms).

Table 3.4 demonstrates a positive relationship between size of firm and experience of different legal problems. Larger small firms are much more likely to encounter problems. This is not surprising given that growing and / or larger small firms are more likely to engage with a broader range of internal issues and external stakeholders. The data suggests that this is particularly notable in relation to employees and taxation. Trading problems also increase with size of firm, probably reflecting broader customer base and greater geographical reach of the larger firms in the sample. However, the 10 – 49 size band requires further unpacking given that the larger size threshold may mask some differences in terms of legal problems.

**Table 3.4 Experience of Legal Problems by Size of Firm**

	<i>Size of firm</i>			
<i>Type of problem***</i>	<i>1 worker (%)</i>	<i>2-9 (%)</i>	<i>10-49 (%)</i>	<i>ALL (%)</i>
<i>Any Legal Problem</i>	22.9	43.7	68.5	29.0
Trading	15.1	28.5	42.1	19.0
Tax	6.1	14.8	23.6	6.0
Employee	2.7	13.6	42.9	6.5
Premises	2.7	10.5	16.6	4.9
Debt/finance	1.9	4.3	5.3	2.5
Intellectual property	2.1	4.6	8.9	2.9
Regulation	3.8	9.1	16.6	5.4
Structure	2.2	7.2	13.0	3.6
Other	1.2	2.7	5.8	1.7
<b>N</b>	<b>7,961</b>	<b>2,151</b>	<b>416</b>	<b>10,528</b>
Base: All sample.				
*** Percentages significantly different at 99% for all cross-tabulations in the table				

### 3.3 Origin and Character of Legal Problems

Given the variety of interactions small businesses have, for example with suppliers, employees, customers and government / regulatory bodies, it is useful to see where legal problems emerge. There are many potential sources of problems faced by businesses: with other organisations, suppliers and customers, with individuals inside and outside the enterprise, depending on the nature of the enterprise. The results show that legal problems were mainly with other businesses, followed by individual members of the public and government (Table 3.5). These patterns in the results are broadly consistent between 2013 and 2015.

**Table 3.5 Who is/was the most recent problem with?**

	2013 (%)	2015 (%)
Other businesses	49.6	48.8
Individual members of the public	19.1	17.7
Government	17.2	16.0
Other	6.9	10.5
Employees	9.5	10.1
<b>N</b>	<b>3,450</b>	<b>2,999</b>
Base: Businesses reporting a problem in the past year. Differences are not statistically significant		

As with the approach taken in the English and Wales Civil and Social Justice Panel Survey, the survey asked how problems were characterised by respondents and their origin. The results confirmed those found in 2013 and with fewer than one in five been classified as 'legal' (Table 3.6). This puts legal problems into the broader context of business problems. The results show that respondents tend not to characterise business problems as legal problems. Few differences were found by respondent or business characteristics.

**Table 3.6 Which, if any, of these descriptions best indicates the character of the problem? Please select all that apply.**

	2013	2015
<i>One or more description(s)</i>	<i>84.1</i>	<i>85.3</i>
Bad luck	13.8	15.8
Moral	14.0	15.5
Private business matter (i.e. not something to involve others with)	29.1	28.9
Criminal	4.5	4.7
Legal	14.3	14.1
Bureaucratic	21.9	21.4
Social	4.7	5.4
<b>N</b>	<b>3,450</b>	<b>2,999</b>
Base: Businesses reporting a problem in the past year. Multiple response.		

The most common source of the legal problems were perceived by respondents to originate ‘from the other side’. In other words, the organisation or individual that the small business had interaction with had done something wrong or were at least at fault (Table 3.7). Conversely, fewer than one in five firms reported that the ‘other side’ thought that the small business had done something wrong or were at fault. Of course, this reports the views of the respondents and not those of the other side involved in the problem so care should be taken in interpretation. Again the results were found to be similar in the 2013 and 2015 surveys.

**Table 3.7 Thinking about the time when the most recent problem first started, would you say...?**

	2013 (%)	2015 (%)
The other side had done something wrong, or were at fault	47.9	49.2
The other side thought your business had done something wrong, or were at fault	17.2	17.8
Neither	31.3	29.5
Don't know	5.7	5.3
<b>N</b>	<b>3,450</b>	<b>2,999</b>
Base: Businesses reporting a problem in the past year. Not statistically significant.		

### 3.4 What types of firms have legal problems? A Multivariate Analysis

A series of multivariate models<sup>10</sup> were performed to understand the relationship between legal problems, the impact of problems, and attitudes controlling for a variety of organisational and owner-manager characteristics. The advantage of this approach over the bi-variate analysis is that it helps to identify the specific relationships between variables in the survey. Through analysis of the marginal effects (MEs) we aim to capture how changes in an independent variable, such as size of enterprise or ethnicity of the respondent, alters the predicted probability of a dependent variable, such as experience of a legal problem, holding all other variables constant. A more detailed explanation and results can be seen in Appendix 1. Throughout the report the discussion focuses on those relationships where the marginal effects (MEs) are statistically different at the 0.5 and 0.10 levels.

#### 3.4.1 *Legal Problems and Business Characteristics*

The multivariate analysis identified some distinctive relationships between the existence of a legal problem in the past year and owner-manager and business characteristics. A summary of those relations that are positive and statistically significant are shown in Figure 3.1; and those that are negative in Figure 3.2. The Figures are useful by showing an overview of the incidence of legal problem types by both respondent and business characteristics. The first column shows if a business had reported any legal problem and the relationship with firm ownership and characteristics, business sectors, size, financial performance and customer base.

Figure 3.1 shows the relationship between specific firm characteristics (in the rows) and types of legal problem. The Figure shows the higher probability of experiencing of a legal problem amongst respondents that have a disability; are sole proprietors / traders; are firms employing 10-49 people; have internal and /or external capacity; and / or those that are expecting to make a loss.

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<sup>10</sup> For more information on methods and results please see Appendix One: Table A2.

On the other hand, Figure 3.2 shows that firms run by white business respondents, older firms, those with one worker and those serving individual customers only are *less* likely to have experienced a legal problem than the base comparator. These relations appear in general and across a range of detailed problems, particularly for white respondents and those with one worker.

Although Figure 3.1 and 3.2 shows those characteristics that have a positive and negative impact on the enterprise in relation to having legal problems, in some cases these characteristics may also be taken to indicate the opposite for the comparator group. For example, in Figure 3.1 the higher incidence of experience of a legal problem amongst respondents with a disability may also be interpreted as those without a disability as having a lower incidence of experiencing a problem. Similarly, in Figure 3.2 the lower incidence of having a legal problem experienced by white respondents may also be interpreted as BME owned enterprises having a higher incidence of experiencing a legal problem. There are also some differences by industry sector. These detailed relationships will now be discussed in turn.



**Figure 3.1 Summary of Positive Factors Associated with Having Legal Problems**

Characteristic Problem Type	Ownership and Firm characteristics	Sectors	Size	Turnover & Profitability
<b>Have had a legal problem</b>	Disabled	Primary, production, construction, wholesale & retail	10-49 workers Internal capacity External capacity	Expected loss
<i>Of which:</i>				
<b>Tax</b>	Disabled, Private limited company, Sole proprietor/sole trader, Family owned firm, Firm age	Production, construction, wholesale & retail, hotels, catering & leisure, transport & communication, Consultancy services	10-49 workers Internal capacity, External capacity	Expected loss
<b>Employment</b>	Disabled Private limited company	Production, Hotel, catering & leisure, transport & communication, education, health, Not-for-profit organisation	10-49 workers Internal capacity, External capacity	
<b>Business Premises</b>	Disabled, Sole proprietor/sole trader	Primary, Hotels catering & leisure	10-49 workers Internal capacity, External capacity	Expected loss
<b>Credit</b>	Disabled Private limited company, Sole proprietor/sole trader, Family owned firm, Firm age	Construction, wholesale & retail	Internal capacity, External capacity	Expected loss
<b>Intellectual Property</b>	BME, Disabled Firm age	Production, transport & communication	10-49 workers Internal capacity, External capacity	
<b>Regulation</b>	Disabled	Primary, production, construction, Hotels, catering & leisure, Transport & communication	10-49 workers Internal capacity, External capacity	Expected loss
<b>Structure</b>	Disabled Firm age <sup>2</sup>	Production, Hotels, catering & leisure	10-49 workers Internal capacity, External capacity	Expected loss
<b>Other</b>	Disabled Firm age		10-49 workers Internal capacity, External capacity	

Note: Figure 3.1 includes only those variables have a positive association with the reported problem that are statistically significant ( $p \leq 0.10$ ). There were no positive relations found in terms of customer base. The Figures do not give an indication of the strength of the ME and so care should be taken in interpreting the summary. Detailed results are in the text and can be found in Appendix One, Table A2 for detailed results.

**Figure 3.2 Summary of Negative Factors Associated with Experience of Legal Problems**

<b>Characteristic</b>	<b>Ownership and Firm characteristics</b>	<b>Sectors</b>	<b>Size</b>	<b>Turnover &amp; Profitability</b>	<b>Customer Base</b>
<b>Problem Type</b>					
<b>Have had a legal problem</b>	<i>White, Firm age</i>		<i>1 worker</i>		<i>Individual customers only</i>
<i>Of which:</i>					
<b>Tax</b>	<i>White</i>		<i>1 worker</i>		<i>Individual customers only</i>
<b>Employment</b>	<i>White</i>		<i>1 worker</i>	<i>Expected profit</i>	
<b>Business Premises</b>	<i>White</i>	<i>Consultancy services</i>	<i>1 worker</i>		
<b>Credit</b>	<i>White</i>	<i>Consultancy services Not-for-profit organisations</i>	<i>1 worker</i>	<i>Expected profit</i>	
<b>Intellectual Property</b>	<i>White</i>	<i>Finance, insurance &amp; real estate</i>	<i>1 worker</i>		<i>Individual customers only</i>
<b>Regulation</b>	<i>White</i>		<i>1 worker</i>		<i>Individual customers only</i>
<b>Structure</b>	<i>White, Sole proprietor/sole trader, Family owned firm, Firm age</i>		<i>1 worker</i>		
<b>Other</b>			<i>1 worker</i>		

Note: Figure 3.2 includes only those variables have a negative association with the reported problem that are statistically significant ( $p \leq 0.10$ ). The Figures do not give an indication of the strength of the ME and so care should be taken in interpreting the summary. Detailed results are in the text and can be found in Appendix One, Table A2.

### *3.4.2 Diversity of Ownership and Legal Problems*

The results show that white respondents were in businesses that were less likely to have experienced a legal problem in the past year (by a probability of 9 percentage points) than BME respondents. This strong association holds across all types of legal problem, from trading through to business structure and is a consistent, key finding in the analysis.

The results were similar for respondents with a disability who were more likely to experience legal problems than those without a disability. Specifically, those respondents with a reported severe disability were more likely to have experienced a problem by 11 percentage points than those without a disability; and those with a mild disability by 10 percentage points.<sup>11</sup> This finding infers a directional relationship. Again this relationship holds across all types of legal problems.

### *3.4.3 Firm Size and Legal Problems*

Ostensibly, the multivariate analysis shown in Figure 3.1 confirms the positive relationship between firm size and incidence of legal problem in the past year found in the cross-tabulations reported above. Detailed analysis shows that firms with one worker were 21 percentage points *less* likely to report a legal problem than those with 2-9 employees; and firms with 10-49 employees were 20 percentage points more likely to report a legal problem. These are considered quite large differences.

However, the multivariate analysis also revealed a bell-shaped relationship between firm size and experience of legal problems. This showed a positive relationship between size of enterprise and having a legal problem but this peaks and then diminishes beyond a certain employment size. Overall we estimate this size-threshold to be at 28 employees beyond which the size effect on reported problems by

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<sup>11</sup> This is defined as having a long-standing illness, disability or infirmity that has troubled you over a period of time or that is likely to affect you over a period of time and is classified as: limited a lot (severe disability); or limited a little (mild disability). See Appendix Two for questionnaire.

respondents then diminishes (Table 3.8).<sup>12</sup> The data is not able to provide reasons for this change but a number of interpretations may be suggested.

**Table 3.8 Size of Enterprise and Legal Problems: Turning Points**

Problem	Employment Size Turning Point
Trading	27
Tax	26
Employees	29
Premises	24
Credit	25
Intellectual Property	46
Regulation	31
Structure	34
Other	27
<b>Overall average*</b>	<b>28</b>
N = 9609 * N = 9571	

One possible explanation for the size threshold may be that one-person, or micro, firms have fewer problems because they do not have many employees, customers, suppliers and external agencies, such as regulatory bodies, to deal with than larger small firms. However, as firms develop and grow then they begin to experience a higher incidence of interactions with all stakeholders and hence encounter problems. As a result, they have to make a structural adjustment in the enterprise involving the introduction of a legal retainer, or the recruitment of in-house capacity which can then help them tackle, anticipate and / or avert impending problems. There may also be a cost element to this process: in order to develop legal capacity a minimum efficient scale of 'problems' is required before business owners are prepared to invest in specific types of legal advice. This is in line with the analysis of legal capacity undertaken in see Section 2 above.

#### 3.4.4 Firm Age and Legal Problems

<sup>12</sup> See Appendix Four for more details.

The experience of having a legal problem in the previous 12 months had a negative but small relationship with age of the enterprise (Figure 3.2). This may be a reflection of the long-standing view of the higher vulnerability of new firms to problems more generally as being at risk of failure (Freeman et al., 1983; Malach et al., 2006). Hence, start-ups are probably more likely to have to address legal matters relating to the set-up of the enterprise and establishment of the enterprise. The overall marginal effects found in the analysis, however, are low and a more sensitive analysis suggests that, as with size of enterprise, this relationship is not linear. This may be a result of larger small firms also having to contend with new legal issues as they grow and their relationships both internal and external to the firm become more complex.

#### *3.4.5 Family Businesses and Legal Problems*

Overall, the relationship between family-owned firms and levels of experiencing a legal problem is not statistically significant and hence unstable. In short, there was no overall statistical difference between family and non-family owned firms in relation to the legal problems considered. This may be explained by the finding that in some cases this relationship was positive (Taxation and Credit) and in others negative (Structure). The reasons for this mixed result may be a multifaceted. Family firms may have additional layers of complexity that trigger specific legal issues related to taxation and business structure, such as business succession and the interaction between personal and business legal matters (see Sharma et al., 2012). There is also some suggestion in the literature that family firms may be more likely to experience governance issues (e.g. Brenes et al., 2011).

#### *3.4.6 Financial Performance and Legal Problems*

The multivariate analysis shows a positive statistical relationship with an expected loss and experience of a legal problem. A firm with an expected financial loss had a higher probability of reporting a legal problem than those at 'break even' by 6 percentage points (ME 0.057). This relationship held across all specific types of legal problem but the probability was strongest in relation to taxation, at five percentage points (ME

0.047) and credit problems, at three percentage points (ME 0.034). Given the potential legal implications associated with experiencing a financial loss, such an observation is not unexpected.

#### *3.4.7 Customer Base and Legal Problems*

Firms with a mixed customer base, that is having both individual and organisation customers, appear to have a higher probability of a legal problem. This difference was particularly the case when compared with the lower probability of those firms that had individual customers only (ME  $-0.051$ ). Those serving individual customers only were also *less* likely to experience problems in relation to trading, taxation, credit, property and regulation than those serving mixed customers. The results suggest that firms dealing with a mixed customer base are more vulnerable to legal problems. Again although the survey does not provide details regarding why this may be the case, it could be a result of the wider span of activities that the small firm serving a mixed customer base has to deal with compared with more niche markets and customer base enterprises.

#### *3.4.8 Legal Status and Legal Problems*

The likelihood of a legal problem is higher amongst private limited firms than all other types by increasing the probability of reporting a legal problem by almost 6 percentage points (ME 0.055). This is also reflected by the *lower* incidence of legal problems amongst sole-traders. If we break down the relationship between legal status of the enterprise and legal problems, private limited companies in particular were more vulnerable to trading (ME 0.048), taxation (ME 0.019) and credit (0.014) problems compared with other types of firms.

#### *3.4.9 Business Sector and Legal Problems*

Experience of having a legal problem varied by business sector: both in terms of the strength of the relationships and their direction.<sup>13</sup> Firms in Primary, Production, Construction, Wholesale and Retail and Transport have a higher probability of experiencing a legal problem overall compared with other sectors. Being in Production increases the probability of a trading problem by 13 percentage points, in Construction by 10 percentage points; Wholesale and retail by 16 percentage points; and Transport by three percentage points. Together with Hotels, catering and leisure, Transport and communications and Consultancy services, these sectors were also more likely to experience taxation problems. Numerous sectors experienced legal problems in relation to employees (Production, Hotels, Catering and Leisure, Education, Health and Not-for-profit). Overall, the data shows that firms in Production experienced the widest range of statistically significant legal problems.

On the other hand, some sectors showed a negative relationship with specific types of problems compared with the base category, but the effect was quite small in magnitude. For example, the Finance, insurance and real estate and Not-for-profit sectors were less likely to experience legal problems in relation to trading. These differences were quite small, however, with a probability of having a negative effect of less than five percentage points.

#### *3.4.10 Legal Capacity and Legal Problems*

Interestingly, firms with both internal or external legal capacity had a higher probability of experiencing a legal problem than those not having capacity. For internal capacity this was an increased probability of 13 percentage points and for external capacity this was 19 percentage points. Within specific types of problems, the highest

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<sup>13</sup> In the case of sector, the base category for the comparison is 'other' business and public administration.

probability occurred in relation to trading for internal capacity, at 10 percentage points and employees, at nine percentage points for external capacity.

Again these results may suggest that legal problems are generating a demand for internal and external legal capacity. In other words, firms experiencing or anticipating an increase in the number and scope of legal problems are more likely to build their internal and external legal capacity than firms with limited or no legal problems. This fits within the broader management style of small business owners who tend to react to problems rather than plan for contingencies (see for example, Lowry et al., 2000). This may also suggest that there is a time-lag between the firm experiencing a problem and their ability to solve the problem. Hence, firms may be playing 'catch-up' in terms of strengthening their legal capacities compared with the demands made upon them. Whether or not firms are able to anticipate legal needs or simply react as and when they occur is worth further investigation. However, the results may suggest that firms with a legal problem require legal advice quickly but are constrained by their resource capabilities.

#### *3.4.11 Threshold Points for Legal Problems*

The earlier cross-tabulation analysis in 3.4.3 suggested that the relationship between size of enterprise and experience of a legal problem is broadly positive: the bigger a small firm is, the more likely it will have a legal problem. This, it is argued, is most probably associated with the increased complexity, breadth and depth of relationships that a firm encounters as it grows in size. The data analysis supports this argument but only to a point. A more refined analysis provides estimates of an employment size-threshold for which a turning point is reached. Beyond this size, the effect of firm size on the incidence of legal problems then diminishes. As can be seen in Table 3.8, for many problem areas this size threshold was in the upper 20 employees and the estimated threshold point for the model overall was 28 employees.<sup>14</sup>

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<sup>14</sup> See Appendix Three for more details.



The analysis also shows differences in the size turning point for legal problems. For problems related to regulation, business structure, and intellectual property, these employment-size thresholds were higher (31, 34 and 46 workers respectively). This demonstrates how different types of legal problems emerge and reach a peak with business size. The analysis also suggests that care should be taken when assuming first, a positive relationship between size of enterprise and incidence of legal problems and second that there is a universal turning point for when legal problems are tackled effectively and diminish.

What causes the effect of firm size to diminish requires further in-depth analysis and possibly qualitative research. However, as firms grow they become more formalised and benefit from economies of scale, networking resources and technological innovation which in turn can help them tackle problems. They may also become better at preventing legal problems, given previous experience in the business development process.

The findings also suggest that firms will be seeking different types of legal support at different stages of their development. Employment, credit and taxation issues are the first to be encountered compared with change to business structure and intellectual property matters. This also suggests, given the relatively small-sized skewedness of the business population that the lower threshold turning points are also indicators of the most common types of legal problems.

## 4. The Impact of Legal Problems

### 4.1 Introduction

The experience of a legal problem has the potential to have serious consequences for the business, including financial cost, loss of market share, damage to reputation, distraction from the core business and health of the owner-manager. In this Chapter we examine the effects of legal problems in terms of business and personnel impacts. The analysis starts with an examination of the effects of legal problems and then goes on to provide evidence on the duration of different types of problems.

### 4.2 Effect of Legal Problem on the Firm

In both 2013 and 2015, survey respondents were asked, in relation to their most recent problem, whether they had experienced up to 11 prompted impacts.

Approximately a half of all firms reporting a problem reported one of the prompted impacts. This was a slightly higher proportion than was found in the 2013 survey.

Table 4.1 shows the most frequently cited impact was loss of income (25.6%), followed by loss of customer/contract (9.2%).

**Table 4.1 Did your business experience any of the following as a result of the most recent problem?**

	2013 (%)	2015 (%)
<i>Any of the prompted responses ***</i>	44.8	50.6
Loss of income	22.5	25.6
Loss of customer/contract	7.1	9.2
Additional costs	9.1	8.8
Inability to complete scheduled work	6.4	8.7
Damage to reputation	6.4	8.0
Damage to relationship with another business	5.6	7.4
Inability to take on new work	5.0	5.2
Damage to property	2.0	1.9
Change in ownership/structure of the business	1.9	1.9
Loss of employees (other than through dismissal/redundancy)	1.2	1.8

Had to cease trading	1.2	1.8
<b>N</b>	<b>3,450</b>	<b>2,999</b>
Note: Multi response.		
Base: Businesses reporting a problem in the past year.		
*** Percentages Significantly different at 99%		

In both the 2013 and 2015 surveys, respondents marked responses from zero to 600 on a scale, indicating a wide range of impacts on the business (Table 4.2). Yet the distribution of responses in both surveys is remarkably similar. Most respondents reported low or moderate impacts, defined as ratings below 300. Approximately 70-72% of respondents reported such impacts. In both surveys, the median and mean ratings are almost identical.

**Table 4.2 Impact Rating of Most Recent Problem**

	<i>2013 (% reporting)</i>	<i>2015 (% reporting)</i>
Very high impact (500-600)	3.9	4.5
High impact (300-499)	25.7	23.6
Moderate impact (100-299)	32.7	33.2
Low impact (0-99)	37.7	38.7
Mean impact	192	191
Median impact	153	151
<b>N</b>	<b>3,450</b>	<b>2,999</b>
Note: respondents could rate problem impact on a scale of 0 (a problem that had only a small impact on the company) up to 600 (a problem that threatened the existence of the company).		
Sample: Business reporting on the most recent problem in the last 12 months.		

#### 4.3 Effect of Legal Problem on Personnel

Legal problems may also have implications for the health and well-being of business owners and their staff. One in five respondents reported up to three prompted health issues as a consequence of their most recent problem (Table 4.3). Stress-related illnesses were reported by 16.1% of respondents.

**Table 4.3 Did you, personally, or anybody else within your business experience any of the following as part of, or as a result of, the most recent problem?**

	2013 (%)	2015 (%)
<i>Any of the prompted effects</i>	17.5	20.1
Stress related illness	14.1	16.1
Other mental health issue	3.4	3.7
Physical ill health	4.1	4.8
<b>N</b>	<b>3,450</b>	<b>2,999</b>
Base: Businesses reporting a problem in the past year. Not statistically significant.		

Although the macro-evidence on whether being a small business owner is more or less stressful than being an employee is mixed (Rietveld et al., 2013), these results show that legal issues do adversely affect the health of business owners.

#### 4.4 Financial Effects of Legal Problems

As indicated in Table 4.1, loss of income was reported as the greatest single impact of a legal problem on the business. Of the respondents reporting some form of adverse effect arising from their most recent legal problem, 780 provided an estimate of the monetary value of loss (Table 4.4).

**Table 4.4 Estimated Monetary Value**

	2013 (£)	2015 (£)
75th	5,000	5,000
50th	1,000	1,000
25th	200	250
Mean monetary value	75,382	25,390
Median monetary value	1,000	1,000
<b>N</b>	<b>778</b>	<b>780</b>
Sample: Businesses providing a monetary estimate of the negative consequences of the most recent problem. Cases with missing data excluded.		

Respondents reported a range of monetary values in both surveys: from £1 to £109m in 2013, and from zero to £4m in 2015. The distribution of responses is very similar

across the two surveys analysed by the median and the quartile data (25, 50, 75). The large difference in mean monetary values reported suggests that there were a small number of very high values reported in 2013 that skew the average.

If we scale this up to the UK small business population as a whole, the total value of loss to small businesses is £9.79 billion in 2015.<sup>15</sup> Of course, if the pattern within the sample is reflected at the national level, this loss will be concentrated in around a quarter of all firms. This should also be set within the context that small firms had a total turnover in 2014 of £1.17 trillion (BIS, 2014a).

#### 4.5 Which Firms are Affected by Legal Problems?

Although incidence of legal problem is a useful indicator of vulnerability, it does not indicate the severity of the problem. Hence, a multivariate analysis of the impact of the legal problem was undertaken in order to clarify extent of the impact. The results demonstrate that the incidence of a legal problem had varying impacts across the sample (Figure 4.1).

The results show that white respondents had a higher probability of reporting *no* tangible impact of experience of a legal problem of almost six percentage points compared with BME respondents (ME 0.059). On the other hand, respondents with either a disability or businesses with one worker had a lower probability of reporting *no* tangible impact of a legal problem. For those with owner-managers with severe levels of disability this was particularly so in relation to a monetary impact.<sup>16</sup>

Respondents with larger firms in the analysis were more likely to report *no* impact of legal problems on their firm (ME 0.039). Those firms serving either individual or organisation customers only were more likely to report *no* impact compared with those with a mixed customer base. They were also less likely to report a monetary

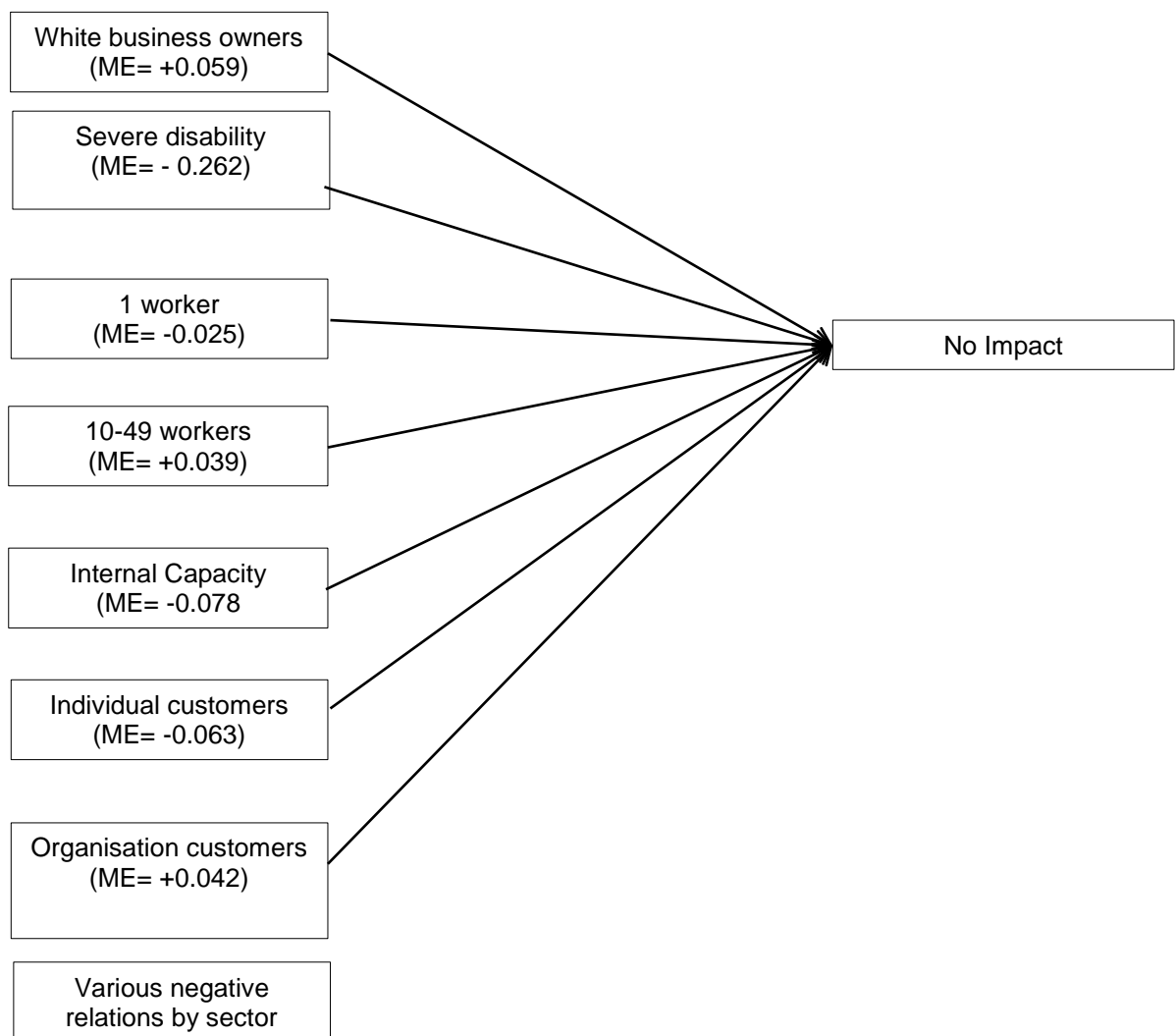
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<sup>15</sup> This estimated by calculating the mean (average) income loss across the whole sample (£1,881) and multiplying it by the total small business population in the UK (5,204,915) (BIS, 2014a).

<sup>16</sup> See Appendix One Table A3 for specific monetary and duration impacts. Note that the results in relation to monetary impact and duration do not utilise marginal effect analysis because these are continuous variables but they do indicate direction.

impact. The impact of a legal problem on the enterprise also varied by business sector. Firms in Primary, Construction and Transport and Communications were less likely to report no impact. However, in relation to sector differences, the analysis only shows statistically significant results for Construction in relation to a monetary impact.

**Figure 4.1 The Effects of Legal Problems**



The analysis showed that firms with internal capacity were less likely to report *no* impact of legal problems by a probability of eight percentage points (ME -0.078). In other words, firms with internal capacity were more likely to report an impact of a

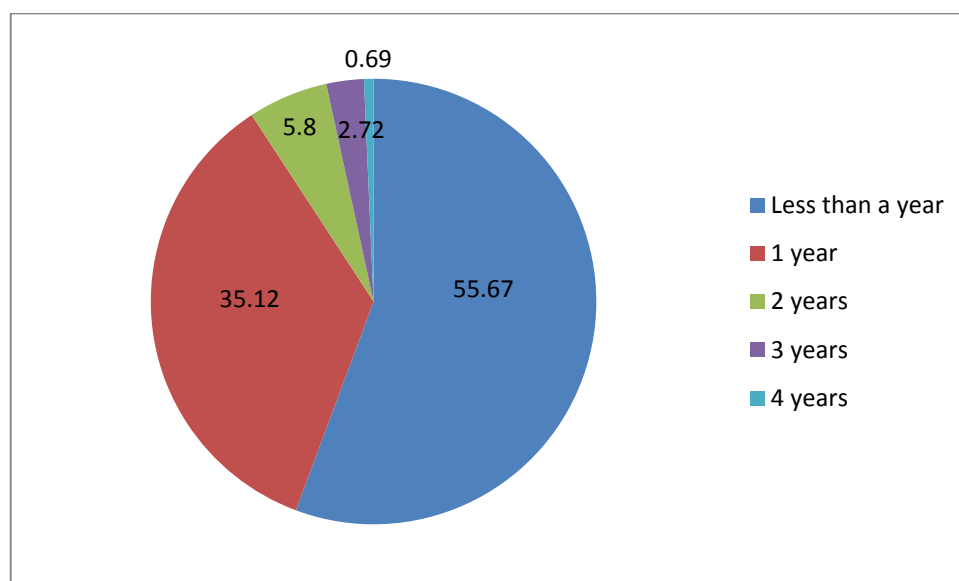
legal problem on their enterprise. As discussed earlier, such firms were also likely to report experience of a legal problem.

The relationship between size of firm and impact adds to the picture. Firms with one worker are less likely to report *no* impact of a legal problem on their firm than those with 2-9 workers; and firms with 10-49 workers are more likely to report impact than those with 2-9 workers. This adds to the earlier analysis regarding size of enterprise and incidence of legal problems: one person enterprises have a higher probability of a legal problem having an impact compared with those employing 2-9; and those employing 10-49 have a lower probability of a legal problem having an impact than the smaller two size-bands. The reasons for such a relationship may be that the capability of firms to deal with legal problems increases with size, even though larger small firms are also more likely to experience legal problems (as shown in earlier section).

#### 4.6 Duration of the Legal Problem

The results show that around 56% of firms were able to solve the main legal problem within the year the problem occurred; whereas 35% of the firms took around one year. The rest of the firms took up to four years to resolve the problem.

**Figure 4.2 Duration of Legal Problems**



N= 2,312

The average duration of having a legal problem varied according to various characteristics of the firm.<sup>17</sup> The results show that BME respondents and those with a severe disability were more likely to experience a legal problem of longer duration. This helps to build a distinctive picture of businesses run by BMEs and people with a disability: they are more likely to experience a legal problem; legal problems they experience are more likely to have an impact, and specifically a monetary impact, and this problem is more likely to be of a longer duration.

The duration of the legal problem was also significantly longer for those with internal legal capacity. Again this implies that the legal problems stimulate a demand for legal services and where continuous there is a need for a more substantial capacity. Especially, for long-lasting problems internal capacity may also be more preferable rather than external capacity. There were no significant results in relation to duration of impact by sector except in wholesale and retail, where firms reported a lower than average duration of problem.

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<sup>17</sup> See Appendix One, Table A3.



## **5. Addressing Legal Problems**

### **5.1 Introduction**

This Section examines how firms respond to a legal problem regarding their paths of action and sources of advice and information used. The experience of a problem in the business can stimulate owner-managers into seeking external sources of legal advice. This may be particularly so for small firms given that the bulk of them do not possess any in-house expertise. However, research for some time has shown that owner-managers also have a strong sense of independence and resistance to external advice seeking (eg. Scase, and Goffee, 1987) so how they deal with legal problems is important to understanding their needs and how access to legal services may be developed.

### **5.2 Actions to Sort Out Legal Problems**

The results from the survey show that respondents tend to try and sort out a legal problem themselves but in doing so, also draw upon their wider network of business friends and colleagues. Of course, this will depend on the nature of the problem and the extent to which this will require legal expertise.

The results suggest a mix of advice sources as respondents seek to resolve problems. In just over half of all cases reporting a legal problem, respondents went about sorting them out entirely on their own (Table 5.1). About one in six respondents reported sorting problems out with help from an independent adviser and slightly fewer than one in 10 took no action. Two new responses categories were added to the 2015 survey, intended to capture the advice and support provided by family members. Seven percent of respondents reported receiving help from family and /or family members sorting out the problem. Although the results are not strictly comparable with the 2013 survey because of developments in the questions asked, the results

verify the approach taken by owner managers to addressing legal problems and the emphasis on informal sources as mainstream advice.

**Table 5.1 Which of these descriptions best indicate how your business went about sorting out the most recent problem?**

	2013 (%)	2015 (%)
Entirely on its own	53.0	52.0
With help from an independent adviser/representative/support service	16.1	15.3
With help from outside business friends/colleagues	11.2	9.8
No action	8.3	8.6
An independent adviser/representative/support service sorted out the problem	8.1	8.1
With help from family members~	n/a	5.6
Family members sorted out the problem~	n/a	1.4
Don't know	5.0	4.0
<b>N</b>	<b>3,450</b>	<b>2,999</b>
Note: Multi response.		
Two new response categories (indicated ~) were added to the question in 2015 - with help from family members; family members sorted out the problem.		
Base: Businesses reporting on their most recent problem in the past year.		
Not statistically significant.		

Understandably, perhaps, businesses with 1 worker were more likely to report sorting out problems on their own (55%, compared with 49% of firms with 2-9 workers and 39% of firms with 10-49 workers) whereas the larger the business the more likely to have an independent adviser help with, or sort out, the problem. These findings are confirmed with the analysis of marginal effects which shows that firms with one worker are 5 percentage points (ME 0.053) more likely to go it alone than larger firms in the sample (Figure 5.1).<sup>18</sup> In contrast, firms with 10-49 workers were 7 percentage points less likely to go it alone (ME -0.072). These results support previous findings suggesting that size of firm is positively related to both use of internal and external legal capacity (Pleasance and Balmer, 2013). It also suggests that businesses with 1 worker have a much lower level of legal capability than larger small firms. However, it may also be a result of the nature of the problem encountered: larger small firms may

<sup>18</sup> See Appendix One, Table A5. The Table also includes results on the use of advisers. The latter is often the inverse of 'Going it alone'.

encounter more severe problems that necessitates access to legal services as well as having more of a culture of openness.

**Figure 5.1 Characteristics of 'Going it Alone'**

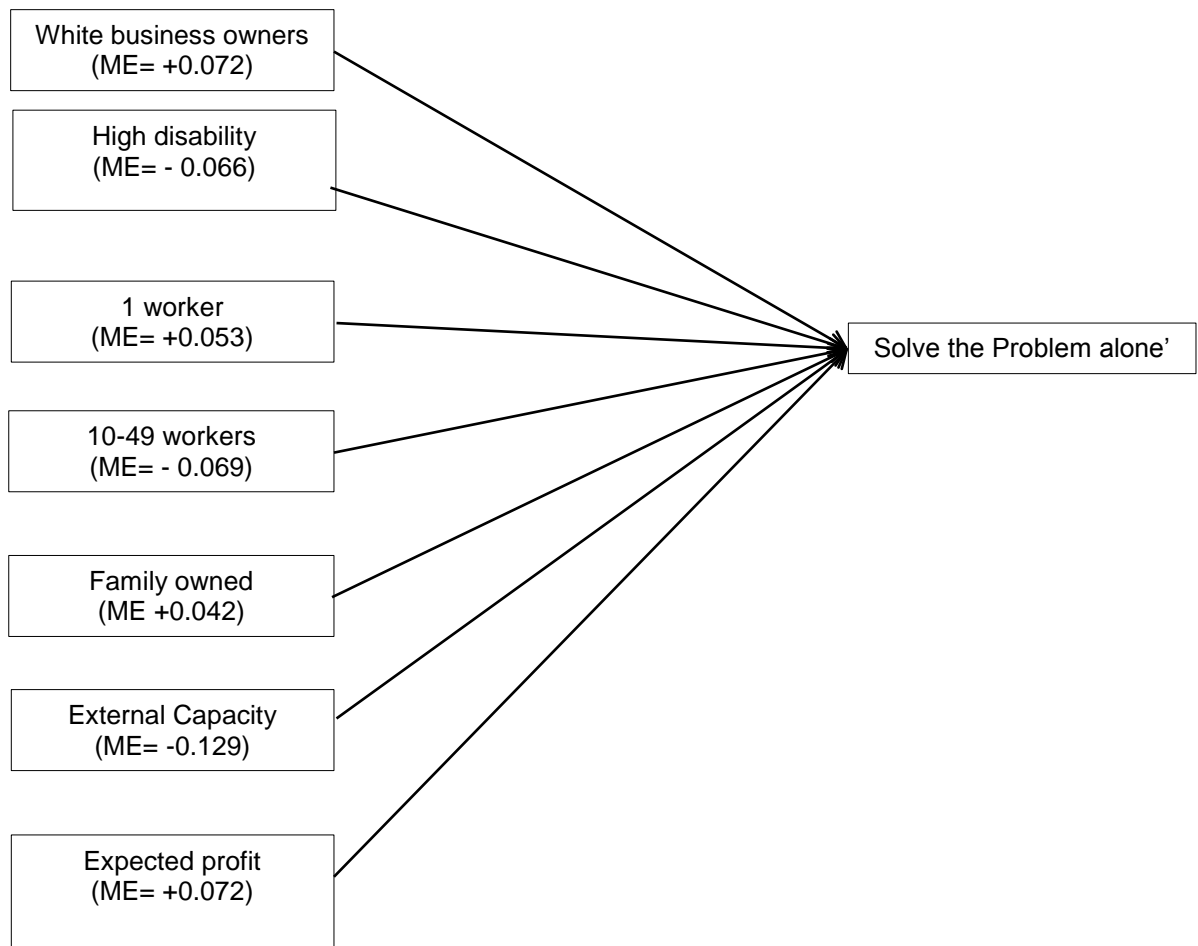


Figure 5.1 also shows how different business characteristics affect the probability of the respondent sorting out the problem alone. White respondents were 7 percentage points more likely to 'go it alone' than BME respondents (ME 0.072). However, those respondents reporting a severe disability were less likely to go it alone by 7 percentage points (ME – 0.066).

One theme that appears to emerge is the gulf between those firms that use legal professionals and those that do not. This is demonstrated by an examination of those firms with internal legal capacity that encounter legal issues as part of their normal

activities (Table 5.2). The most frequent response by these firms is first to look for information and resources on the internet (34.9%). However, even though they possessed internal capacity, for these businesses there was less evidence of a ‘go it alone’ strategy: 26.9% would talk to a lawyer outside the business and 13.8% to a lawyer inside the business. The pattern of responses is similar to that found in 2013, although slightly fewer respondents in 2015 reported using the internet as the initial source to solve problems and slightly more reported using a lawyer outside the business.

**Table 5.2. If your business encounters a legal issue as part of the business’s normal activities (for example, around employee rights) which of the following is most likely to happen first?**

	<i>2013 (%)</i>	<i>2015 (%)</i>
Look for information/resources on the Internet	42.0	34.9
Talk to a lawyer outside the business	19.5	26.9
Talk to lawyer in the business	13.8	13.8
Talk to another colleague in the business	10.1	9.7
Talk to someone else outside the business	7.2	4.7
Other	7.4	10.0
<b>N</b>	<b>552</b>	<b>512</b>
Base: Businesses with a qualified lawyer or someone trained in handling legal issues in-house. Differences not statistically significant.		

### 5.3 Levels of Legal Expertise and Sources Used

The results shown in Table 5.1 showed that respondents draw upon a range of advisers in seeking to address legal problems and, ostensibly, some of these advisers will be more qualified than others. Table 5.3 builds upon this by examining the perceived knowledge of advisers in relation to the most recent problem faced. The results suggest that respondents rated business friends’/colleagues’ levels of legal knowledge in relation to the issues faced as ‘excellent’ or ‘good’ (59%). The rating of the knowledge of family members, shown in the second column, is unsurprisingly, lower but even in this case 43.6% is rated excellent or good. This possibly reflects a

trust in the person giving the advice, given that trust in a business context includes elements of integrity, benevolence and competency (Mayer et al., 1995).

**Table 5.3 Business friends/colleagues and family members - level of legal / professional knowledge in relation to the most recent problem faced 2015**

	(a) Business friends/ colleagues (%)	(b) Family members (%)
Excellent knowledge	20.4	13.1
Good knowledge	38.6	30.5
Adequate knowledge	24.7	31.9
A little knowledge	13.3	14.9
No knowledge at all	1.8	8.7
Don't know	1.1	1.0
<b>N</b>	<b>357</b>	<b>197</b>
Base: Businesses reporting a problem in the past year <i>and</i> reporting business friends/ colleagues or family members as helping to sort out the most recent problem reported. Not statistically significant.		

In seeking advice and support for their most recent legal problem, Table 5.4 shows the diverse sources of advice used by respondents. These span specialist legal services, local advice organisations and membership bodies. Clearly, the strength of their ongoing relationship with accountants is reflected in their choice of adviser.

**Table 5.4 You said that you had help from business friends/colleagues and/or the help of an adviser/representative/support service. Was the help that you got from any of the following?**

	2015 (%)
Solicitor's firm	15.0
Independent barrister	4.8
Other organisation offering legal advice	2.6
Accountant	20.9
Other financial/tax adviser	2.0
Debt collection/recovery service	2.9
HR/Employment service	3.6
(Insurance) Loss adjuster	1.2
Other specialist support service	2.7
Trade body/professional association	9.6
Chamber of Commerce	1.1
Local enterprise agency	3.5
Other trade/business organisation	3.5
Business Link	4.0
Other government advice service	1.3
Other independent source of help	8.7
None of these	33.1
N	558

#### 5.4 Sources of Help Used and Type of Legal Problem

Table 5.5 shows the sources of help that firms use in relation to particular types of legal problem. The most frequently used source in relation to trading problems includes solicitors (reported by 23.8% of firms reporting such problems) followed by patent/trademark attorney/agent (20.2%). The use of a legal helpline was the most frequently used source of help in relation to taxation (33.5%) followed by patent/trademark attorney/agent (26.2%). In some categories of problem, specialist services are sought such as patent/trademark attorney/agent for intellectual property problems and licensed conveyancer for business premises problems. Overall, the most frequently used source of advice derived from solicitors (922 firms), followed by legal helpline (243 firms) and barristers (113 firms). The results also show that respondents present a range of problems to advisers. For example, patent/trademark attorneys and

license conveyancers are approached for advice in areas outside of their (reserved) normal activities. The reasons for this are not evident in the data, but are most probably a result of respondents not necessarily knowing who to approach, possibly approaching trusted advisers known to them from dealing with an earlier matter, or even approaching an adviser before being moved on to another adviser.

The main delivery method of legal services is shown in Table 5.6. Whilst multiple methods of service delivery are used, in-person meetings are the most popular across all providers except patent attorneys and legal helplines. For solicitors, email and telephone delivery methods were also important. Barristers and licensed conveyancers also used the internet and texting. Patent attorneys used email as their main method, followed by face-to-face meetings.

**Table 5.5 Services helping businesses in the past 12 months 2015**

	<i>Solicitors' firm</i>	<i>Barrister</i>	<i>Licensed conveyancer</i>	<i>Patent/trademark attorney/agent</i>	<i>A legal helpline</i>	<i>Another legal service</i>
Trading (including commercial contracts)	23.8	16.9	12.6	20.0	18.7	19.8
Tax	21.9	11.2	17.7	26.2	33.5	17.2
Crime	4.6	16.0	7.5	4.7	8.5	12.4
Employment (excluding work related injury/illness)	16.4	16.8	14.0	7.5	27.5	9.8
Work related injury/illness	5.5	4.6	5.0	3.6	10.5	3.6
Business premises	21.6	8.7	34.6	5.1	7.4	1.5
Finance/insurance	13.9	7.2	15.3	10.5	17.3	14.2
Debt	8.9	18.7	7.0	4.3	16.3	12.2
Intellectual property	8.0	12.4	6.5	70.2	7.1	11.3
Government regulation/competition	5.8	7.5	7.4	6.1	10.7	8.6
Environmental/nuisance	3.3	2.8	7.3	1.8	8.1	2.9
Business set-up/legal-status/ownership	17.9	7.8	11.6	11.7	15.4	8.7
Other	23.1	30.1	34.8	6.8	16.0	43.3
<b>N</b>	<b>922</b>	<b>113</b>	<b>89</b>	<b>110</b>	<b>243</b>	<b>46</b>
Note: Multi-response.						
Base: Businesses reporting use of <i>each</i> type of service in the past year.						



**Table 5.6 How was this service MAINLY delivered to your business?**

	<i>Solicitors' firm (%)</i>	<i>Barrister (%)</i>	<i>Licensed conveyancer (%)</i>	<i>Patent/trademark attorney/agent (%)</i>	<i>A legal helpline (%)</i>	<i>Another legal service (%)</i>
In-person meetings	35.9	49.0	30.7	23.1	5.3	21.7
Telephone conversations	26.5	16.6	24.7	21.2	79.9	21.6
Correspondence by post	6.7	5.0	11.1	9.7	1.2	1.6
Through someone else	1.4	8.8	2.3	1.9	1.6	0.8
Texting	0.3	20.4	30.5	2.3	0.2	49.7
Email	28.6	0.2	0.8	37.7	7.0	4.5
Internet (excluding email)	0.8	49.0	30.7	4.1	4.7	21.7
<b>N</b>	<b>922</b>	<b>113</b>	<b>89</b>	<b>110</b>	<b>243</b>	<b>46</b>
Base: Businesses reporting use of <i>each</i> type of service in the past year.						

## 5.5 Reasons for Choice of Legal Provider

Choosing a legal service is a major consideration for owner-managers and can be influenced by a variety of factors (Table 5.7). Provider reputation, legal specialism and prior use were reported as the most important reasons for choosing particular providers rather than cost concerns. Recommendations were also important. Owner-managers are careful in the selection of provider and it is the provider's reputation and specialism that are dominant factors.

**Table 5.7 Most important factor in choice of provider in relation to most recent problem 2015**

	%
Their reputation	30.1
Specialist in the area of law	24.5
Whether you have used them previously	24.4
Cost of advice	15.7
They were recommended to me by friends or family	9.9
Convenience of where they are located	9.8
They were family/friends believed to have relevant legal/managerial/business expertise	9.4
They were recommended to me by my accountant	8.6
They were recommended to me by my trade body	8.4
Speed of delivery	7.6
Quality mark	4.2
Distance from where you live	3.3
Gender of the adviser	0.7
Other response	6.6
Don't know	6.1
<b>N</b>	<b>931</b>
Note: Multiple response. Up to three responses permitted.	
Base: Businesses reporting experience of a problem and taking action and using formal external sources included.	

The search for help and finding an appropriate provider can take time and may be costly. One third of respondents reported contacting support providers who were unable to help them (Table 5.8). This proportion is higher than the quarter of the sample reporting similarly in the 2013 Survey. The reasons for these results may be varied. The results may not necessarily mean that there is a major supply-side gap.

However, it does show that the first point of advice seeking may not necessarily be the final chosen source. This may be a result of the complicated nature of the problem, or a lack of readily available information on services on offer. The Table also shows a consistent pattern between 2013 and 2015, with solicitors and accountants having the highest levels of contact by firms but were unable to help them.

**Table 5.8 And did your business contact any of the following and to try to get help but found they weren't able to help you?**

	2013 (%)	2015 (%)
<i>One of the prompted sources ***</i>	24.4	33.0
Solicitor's firm	6.1	9.4
Accountant	7.2	8.4
Other organisation offering legal advice	3.4	5.4
Trade body/professional association	3.3	4.5
Other government advice service	3.7	4.3
Other trade/business organisation	1.7	2.3
Business Link	3.3	2.2
Independent barrister	2.4	2.2
Other financial/tax adviser	1.7	2.2
Other specialist support service	1.7	2.0
HR/Employment service	1.4	2.0
Debt collection/recovery service	1.7	1.5
Chamber of Commerce	1.6	0.9
Local enterprise agency	1.0	0.5
(Insurance) Loss adjuster	0.8	0.5
Other independent source of help	1.0	1.7
<b>N</b>	<b>3,450</b>	<b>2,999</b>
Note: Multi response.		
Base: Businesses reporting a problem in the past year.		
*** Percentages Significantly different at 99%		

## 5.6 Sources of Information on Legal Problems

Approximately one in four respondents reported using the internet, or other information sources, in order to help to sort out the problem they faced (Table 5.9). This is very similar to the proportion reporting use of such sources in the 2013 Survey suggesting no upsurge in the use of internet-based advice or support and that this

method of sorting out problems may have plateaued. However, it confirms that, in seeking advice, the internet is now an important element of respondents' pathways to seeking information and / or a resolution to a problem.

**Table 5.9 Did your business use the internet or any leaflet, booklet or book to help sort out the problem?**

	<i>2013 (%)</i>	<i>2015 (%)</i>
<i>One of the prompted sources</i>	41.9	43.3
Yes, the Internet to obtain contact details	20.2	21.5
Yes, the Internet for information on what I should do	20.6	21.3
Yes, the Internet for information on my business's legal position	16.1	15.1
Yes, leaflet, booklet or book	3.8	2.7
<b>N</b>	<b>3450</b>	<b>2,999</b>
Base: Businesses reporting a problem in the past year. Not statistically significant.		

In one quarter of cases, respondents reported some level of involvement with legal (or formal) mechanisms as part of the problem or its solution (Table 5.10). This is very similar to the proportion in 2013. Although the most common response was contact with the other party's lawyer/formal agent, small numbers reported a deeper engagement with the law, or with formal mechanisms such as courts, tribunals and the police. However, when the case did end up in court, less than a half were represented by a lawyer (Table 5.11).

**Table 5.10 And did any of the following things happen as part of the most recent problem or sorting the problem out?**

	2013	2015
<i>One of the prompted effects</i>	24.2	24.8
Your business was contacted by a lawyer or formal agent (e.g. debt collection agency) of the other side	5.3	6.2
Online dispute resolution	6.4	5.7
Conciliation, mediation or arbitration took place	5.0	5.7
Legal proceedings commenced/a court became involved	3.4	3.9
A regulator or ombudsman became involved	2.7	2.2
The police became involved	1.8	1.8
There was a court hearing	1.6	1.7
A formal appeals service became involved	1.6	1.5
Tribunal proceedings commenced/a tribunal became involved	1.0	1.0
There was a tribunal hearing	0.6	0.9
<b>N</b>	<b>3,450</b>	<b>2,999</b>
Base: Businesses reporting a problem in the past year. Not statistically significant.		

**Table 5.11 And did a lawyer appear on behalf of your business at any court hearing?**

	2013	2015
Yes	48.2	45.6
No	51.8	54.4
<b>N</b>	<b>56</b>	<b>52</b>
Base: Business reporting a court hearing. Not statistically significant.		

## 5.7 Accessibility of Legal Advice and Support

The results of the survey suggest that access to legal advice is not a problem overall in relation to the growth of the firm (Table 5.15). However, as shown in the second column of Table 5.12, firms reporting a legal problem were more likely to agree strongly or agree with the statement than the sample as a whole, even though the

overall pattern of reporting does not suggest that there is a lack of supply when firms are looking for a legal service.

**Table 5.12 Not being able to find a suitable legal services provider when I need one has affected the growth of my business 2015**

	All sample (%)	Businesses reporting a legal problem in past year (%)
Agree strongly	1.0	2.3
Agree	3.1	7.0
Neither agree nor disagree	23.5	28.0
Disagree	25.5	25.8
Disagree strongly	31.6	26.5
Don't know	15.4	10.4
<b>N</b>	<b>10,528</b>	<b>3,049</b>
Base: All sample in first column; businesses reporting a problem in past year in second column.		

## 6. The Outcome of Legal Problems

### 6.1 Introduction

In this section, the analysis examines how legal problems were concluded. This is important in that it provides a picture of the way in which disputes are resolved as well as the outcome. These may have been concluded without recourse to use of the legal profession or may have involved court action.

### 6.2 Outcomes of Legal Problems

Respondents reporting that their problem was over (or most likely now over) were asked how the problem concluded. Most commonly, issues were resolved by the parties, either in agreement or by one side acting unilaterally, rather than through legal means or through the involvement of third parties (Table 6.1). This supports the previously reported findings that a large proportion of the firms try to settle informally (see for example, Table 5.10). The profile of responses is very similar to that found in the 2013 Survey.

**Table 6.1 Conclusion to most recent problem**

	2013 (%)	2015 (%)
<b>Agreement reached:</b>	<b>47.4</b>	<b>45.7</b>
- Agreement reached directly between your business and the other side	38.4	37.1
- Agreement reached through somebody who was acting for your business	5.4	5.3
- Agreement reached through conciliation, mediation or arbitration sessions, hosted by an independent person/organisation	3.6	3.3
<b>Unilateral action:</b>	<b>23.3</b>	<b>20.7</b>
- Your business acted independently of the other side to sort out problem	10.3	10.9
- The other side acted independently to sort out problem	10.0	9.8
<b>Problem resolved or unresolved without action:</b>	<b>14.3</b>	<b>15.7</b>
- The problem sorted itself out without your business or the other side doing anything	8.3	8.2
- Your business is just putting up with the problem	6.0	7.5
<b>Formal third party mechanism:</b>	<b>13.2</b>	<b>11.4</b>
- Online dispute resolution	7.1	6.5
- Decision of a court/tribunal	3.4	2.3

- Decision/action of an independent third party	1.3	1.8
- Decision of a formal appeals service	1.4	0.8
<b><i>Don't know</i></b>	<b><i>5.0</i></b>	<b><i>6.5</i></b>
<b>N</b>	<b>2,148</b>	<b>1,837</b>
Base: Businesses reporting a problem in the past year <i>and</i> that their most recent problem was now over or most likely now over. Differences were not statistically significant.		

Respondents reported outcomes that were completely or mostly in their favour (Table 6.2). Again respondents reported only few differences with the 2013 results, particularly in relation to having an outcome completely in their favour, although these were statistically significant.

**Table 6.2 Respondents' perceptions of outcome of most recent problem**

	2013 (%)	2015 (%)
Completely in your favour **	46.7	41.0
Mostly in your favour	29.0	33.0
Mostly not in your favour	8.2	8.5
Not at all in your favour	8.9	9.9
Don't know	7.2	7.6
<b>N</b>	<b>2148</b>	<b>1,837</b>
Base: Businesses reporting a problem in the past year and that their most recent problem was now over or most likely now over.		
** Percentages Significantly different at 95%		



## 7. Attitudes to Risk, Law and Legal Services

### 7.1 Introduction

This section sets out an analysis of the attitudes to business risk, law and legal services of all those in the survey. Respondents were asked a series of questions to ascertain their attitudes to the influence of the law, and of legal professionals, on their business practices and, specifically, with regard to solving specific business problems.

Respondents were invited to show their agreement, or disagreement, with seven attitude statements. We set out these statements and the data from respondents below.

### 7.2 Attitudes to Law and Regulation

A markedly larger proportion of owner-managers reported agreement with the statement *'law and regulation provide a fair environment for business to succeed'*: 45% in 2015, compared with 30% in 2013 (Table 7.1). These differences are statistically significant. Two possible influences on such improved perceptions by respondents might be hypothesised. First, the Conservative-Liberal Democrat coalition Government (2010-2015) implemented a range of policies such as 'One-in, two-out' intended to reduce regulatory burdens on businesses. Government claims to have saved businesses £2.2bn during the previous parliament (BIS 2014b). Other sources have found fewer business owners reporting regulation as a burden or obstacle to success compared with a few years ago (Jigsaw Research 2014; BIS 2015a, 2014c). Relatedly, government ministers have been keen to promote their agenda to reduce the impact of regulation on business. Second, the economic environment has continued to improve since 2013 suggesting that surviving firms might be less fearful of what have been very uncertain trading conditions. Macroeconomic indicators such as GDP, inflation and employment/unemployment reflect an improving economic environment in relation to two years ago. Both of these indicators might be expected to increase business owners' optimism and perceptions of regulatory burdens.

**Table 7.1 'Law and regulation provide a fair environment for business to succeed'**

	2013 (%)	2015 (%)
Agree strongly *	3.9	6.7
Agree ***	26.0	38.3
Neither agree nor disagree ***	42.0	32.2
Disagree ***	16.0	10.9
Disagree strongly **	6.6	2.9
Don't know **	5.5	9.0
<b>N</b>	<b>9,548</b>	<b>10,528</b>
Base: All sample.		
*** Percentages Significantly different at 99%		
** Percentages significantly different at 95%		
* Percentages significantly different at 90%		

If we unpack the responses in Table 7.1 by business characteristics we find some statistically significant differences.<sup>19</sup> First, white respondents and those with a disability are less likely to agree with the statement than BME respondents. Second, in terms of organisational characteristics, there is a positive relationship with size of enterprise and agreement with the statement. Family owned firms were less likely to agree with the statement than non-family owned firms. Those with internal or external legal capacity were more likely to agree with the statement than those without. Finally, firms expecting a profit were more likely to agree with the statement than those at break even.

From a sector perspective, firms in Production, Construction, and Wholesale and Retail were less likely to agree with the statement than those in the base category.<sup>20</sup> This contrasts with respondents from Education, Consultancy and Not-for-profit organisations who are more likely to agree with the statement.

<sup>19</sup> See Appendix One, Table A5 for estimated detailed results.

<sup>20</sup> In this case, the base category is 'Other business and public administration'.

### 7.3 Attitudes to Cost of Lawyers

The literature that does exist suggests that cost of legal services is one of the deterrents to their use by small firms (Pleasance and Balmer, 2013). Respondents in the 2015 survey show mixed views regarding the cost-effectiveness of lawyers to resolve legal issues (Table 7.2). Almost a half of respondents disagreed or disagreed strongly with the statement regarding the cost effectiveness of lawyers. There were minor changes in the responses between 2013 and 2015, and notably the proportion of those disagreeing strongly with the statement declined whilst those disagreeing increased. However, no significant changes are found for the agreement responses.

**Table 7.2 'Lawyers provide a cost effective means to resolve legal issues'**

	2013 (%)	2015 (%)
Agree strongly	1.6	1.4
Agree	10.7	12.0
Neither agree nor disagree ***	35.6	29.2
Disagree ***	25.5	31.8
Disagree strongly ***	19.5	15.3
Don't know **	7.0	10.3
<b>N</b>	<b>9,548</b>	<b>10,528</b>
Base: All sample.		
*** Percentages Significantly different at 99%		
** Percentages significantly different at 95%		
* Percentages significantly different at 90%		

The responses to the statement also revealed some statistically significant variations by respondent and organisation characteristics. White respondents were less likely on average to agree with the statement than BME respondents, as were those with a mild disability compared with no disability.

In terms of organisational characteristics, larger small firms were more likely to agree with the statement. This was a strong clear statistical relationship. Again this

underlines the resource constraints of one-person and micro enterprises compared with larger small firms.<sup>21</sup>

#### 7.4 Attitudes to Trust

Undertaking business involves working within a legal framework and set within industry norms and practices. The overwhelming majority of respondents (71%) agreed strongly or agreed with the statement that when doing business I generally trust the people that I come into contact with (Table 7.3). Trust in a business context can comprise a range of elements (Mayer et al., 1995) and is crucial in the role of business advice (Bennett and Robson, 2004). The high level of trust reported may be a result of the selectivity of whom owner-managers are prepared to engage with combined with the environment that the rule of law promotes for doing business.

**Table 7.3 ‘When doing business, I generally trust the people that I come into contact with (e.g. suppliers, customers, employees etc)’ 2015**

	%
Agree strongly	8.5
Agree	62.6
Neither agree nor disagree	20.4
Disagree	3.9
Disagree strongly	0.7
Don’t know	3.9
<b>N</b>	<b>10,528</b>
Base: All sample.	

In terms of business respondent characteristics, white respondents were on average more likely to agree with the statement than BME respondents. Conversely, those with a mild disability were less likely to agree with the statement than those with no disability.

In terms of business characteristics, those respondents with internal legal capacity or serving individual customers only, were less likely to agree with the statement. In

<sup>21</sup> See Appendix One, Table A5 for detailed results.

terms of business sector, respondents from firms operating in Transport were also less likely than average to agree with the respondent.

#### 7.5 Are Lawyers Used as a Last Resort?

Business owner-managers tend to use formal legal services to solve business problems as a last resort: almost a half agreed strongly or agreed with the statement (Table 7.4). A number of reasons may explain this pattern. First, business owners tend to sort out their business problems ‘alone’, or informally (see earlier Section 5), without recourse to engaging with formal or paid advice and support. Many business problems may not be sufficiently serious enough to access legal services. Second, when engaging with professional services for advice, business owners tend to go to those suppliers that they have used previously and built up a relationship. In most cases, this involves accountants rather than lawyers although it is also argued that trust is context dependent (see for example, Blackburn et al., 2010; Gooderham et al., 2004). Finally, as implied in Table 7.2, owner-managers regard lawyers as expensive and are thus used very carefully and most probably when other services have been tried or even exhausted. This is not surprising given that the cost of using a legal service tends to be based on inputs such as the time and expertise required, rather than the size of the organisation purchasing the service.

**Table 7.4 ‘I use a legal services provider to solve business problems as a last resort’ 2015**

	%
Agree strongly	15.9
Agree	34.0
Neither agree nor disagree	21.4
Disagree	8.1
Disagree strongly	6.0
Don’t know	14.6
<b>N</b>	<b>10,528</b>
Base: All sample.	

There were relatively fewer variations by business respondent and type to this statement. In terms of respondent characteristics, white respondents were more likely on average to agree with the statement than BME respondents, a finding which resonates with their views regarding the relatively high cost of lawyers.

The relationship with size of enterprise is less equivocal. Firms with one-worker were less likely on average to agree with the statement but there is no difference for the larger size-bands. Firms with external capacity were also more likely to agree with the statement. Firms serving individual customers only were less likely to agree with the statement. Those operating in Wholesale and retail, Hotels, catering and leisure, Transport and communication and Consultancy were more likely to agree with the statement.

#### 7.6 Are Legal Services Accessible?

Whether or not owner-managers find it easy to find a suitable legal service when needed is open to question. As discussed in Section 5, around a third of those seeking advice had approached an external service provider listed but they were unable to help solve the problem. When asked *'When I need one, I find it easy to find a suitable legal services provider that I can afford'*, the bulk of respondents, in the sample as a whole, neither agreed or disagreed (30.4%) or reported don't know (26.0%) (Table 7.5). This suggests that they were ambivalent or had not tried to access the legal system. On the other hand, almost a quarter of all respondents agreed or agreed strongly with the statement. Almost one in five respondents disagreed or strongly disagreed with the statements – a finding that may be taken to imply an unmet legal services need. Further analysis in the final column of Table 7.5 shows that those firms that had used a legal service provider tended to find it easier to do so than the sample as a whole. Over a half of this sub-sample strongly agreed or agreed with the statement. This does confirm the suggestion that the results for the sample as a whole may not be experience based. However, it is also notable that almost one in five disagreed or disagreed strongly with the statement.

**Table 7.5 ‘When I need one, I find it easy to find a suitable legal services provider that I can afford’ 2015**

	<i>%</i>	<i>% Using Legal Service</i>
Agree strongly	3.8	10.2
Agree	20.9	42.1
Neither agree nor disagree	30.4	24.8
Disagree	12.1	13.2
Disagree strongly	6.8	4.8
Don’t know	26.0	5.0
<b>N</b>	<b>10,528~</b>	<b>1,298^</b>
Base: ~All sample. ^ Only includes those respondents that had used a Solicitor, Barrister, Licensed conveyancer, Patent/trademark attorney/ agent, A legal helpline, or Another legal service.		

The analysis reveals some important statistically significant differences by respondent and business characteristics. Respondents with a severe reported disability were less likely on average to agree with the statement. This adds to the growing distinctive profile of these business owners regarding their experience of the legal profession.<sup>22</sup>

In terms of business characteristics, those expecting a financial loss were less likely to agree with the statement. Conversely, there appeared to be a positive relationship with statement agreement and size of business: firms with one-worker were less likely to agree with the statement and larger small firm respondents agree with the statement. Respondents of older firms were also more likely to agree with the statement suggesting that understanding where to go for legal advice may involve a learning process. Firms having organisation customers only were also more likely to agree with the statement. This may be a reflection of the contractual obligations they may have to undertake when dealing with other businesses and organisations. Whether or not having to find a legal service raises levels of understanding about the market for legal services amongst small firms, however, remains open to debate but these findings suggest that this is the case.

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<sup>22</sup> See Appendix One: Table A5.

Firms with internal or external legal capacity were more likely to agree with the statement than those without capacity. Whilst this is not surprising, it may imply that some firms may lack the wherewithal to find a suitable supplier of legal advice, or that the supply side is not adequately marketing its services clearly. Collectively, this may be taken to imply that there is some unmet legal need.

Finally, there are some differences between different business sectors. Those in Production, Transport and communication and Not-for-profit organisations were less likely on average to agree with the statement. On the other hand, those in Finance were more likely to agree. Again this may reflect the nature of the business operations and the frequency with which respondents have to engage with the legal system.

#### 7.7 Is the Need for Legal Services Increasing?

Overall, the need to use legal services has not increased in the past two years (Table 7.6). In particular, almost 60% disagreed or disagreed strongly with the statement in Table 7.6. This is supported by the reduced incidence of legal problems reported in section 3. One possible explanation for this pattern of response may be a result of the improving trading conditions.

**Table 7.6 'I feel the need to take legal advice more often than I did two years ago (or when the business first started trading, if less than two years ago)' 2015**

	%
Agree strongly	1.1
Agree	5.1
Neither agree nor disagree	23.7
Disagree	26.4
Disagree strongly	31.9
Don't know	11.7
<b>N</b>	<b>10,528</b>
Base: All sample.	



An examination of the characteristics of the respondent show that white respondents are less likely on average to agree with the statement than BME respondents see Table 7.6.<sup>23</sup> Those with mild levels of disability and severe levels of disability are, however, more likely to agree with the statement. Taken together, these results suggest a growing need for legal advice amongst BME and disabled respondent businesses over the past two years.

There also appear a number of differences by size of firm that are statistically significant. These imply that one-person enterprises are less likely on average to feel the need to take on legal advice than those in the 2-9 size band; and those in the 2-9 size band less than those in the 10-49 size-band. The underlying reasons for this difference is difficult to isolate in the survey data but one possible explanation may be that these firms are developing and growing and encountering new internal and external situations, leading to them having to take-up more legal advice (see Marcum and Blair., 2011). Also, as shown earlier, smaller firms prefer more informal channels of advice with lower costs.

Firms with either internal or external legal advice are also more likely on average to feel the need to take up more legal advice than they did two years ago. The existence of such capacity may in fact be a reflection of the additional advice needed. On the other hand, respondents of family-owned enterprises and those expecting a loss were less likely to feel the need to take up legal advice more often than two years ago.

In terms of market profile, firms serving individual customers only were more likely to agree with the statement than those with a mixed customer base. Almost a half of the business sectors were more likely to agree with the statement than average, and none more likely to disagree with the statement. The strongest statistically significant differences were in Construction and Finance, possibly reflecting the increased regulatory environment in these sectors. The results confirm the theme that legal

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<sup>23</sup> See Appendix One, Table A5.

needs by firms are to a major extent dependent on their developmental context and business type (see Malach et al., 2006).

## 7.8 Attitudes by Size of Enterprise

One of the recurring findings in the above analysis is the variations in responses by size of firm. Broadly speaking, respondents were more likely to agree (or agree strongly) with each of the attitude statements, the larger the size of the business (Table 7.7). The bulk of the comparisons by size of firm are statistically significant (see Appendix One: Table A6). Firms employing 2-9 or 10-49 workers are more likely to consider that lawyers provide a cost-effective means to resolve legal issues than those with 1 worker. They are also more likely to agree that, when needed, they find it easier to find a suitable legal service provider that they can afford.

Larger small firms might be more aware of the kinds of solutions offered by the legal profession for business problems and better equipped to find and deal with legal professionals than micro firms and 1-person businesses because of the fact that they have had to encounter legal issues and hence engage with legal services. This is perhaps to be expected as size of firm is also associated with higher levels of internal and external legal capacity. Larger and growing small firms might therefore be more likely to report growth being constrained by not being able to find a suitable legal services provider and are much more likely to feel that they need to take legal advice more often than they did two years ago.

Reported levels of trust when doing business are marginally lower in larger firms. This may also be a reflection of the larger number of relationships these businesses have, suggesting that a willingness to turn to formal contracts and the law may be a more common practice in such businesses. Larger firms are still more likely to report using legal services providers as a last resort, suggesting that trust may still play an important role in day-to-day business practice or that internal capacity is often sufficient to handle such problems.

**Table 7.7 Attitudes to Risk, Law and Legal Services by Size of Firm**

<b>% Strongly Agreed or Agreed:</b>	<i>1 worker</i>	<i>2-9</i>	<i>10-49</i>	<i>ALL</i>
Law and regulation provide a fair environment for business to succeed	43.9	47.7*	52.9**	45.0***
Lawyers provide a cost effective means to resolve legal issues	12.0***	16.5***	26.0***	13.4***
When doing business, I generally trust the people that I come into contact with	71.3	71.1	65.9	71.1*
I use a legal services provider to solve business problems as a last resort	46.9***	58.9***	61.1***	49.9***
When I need one, I find it easy to find a suitable legal services provider that I can afford	20.2***	37.2***	45.8***	24.7***
Not being able to find a suitable legal services provider when I need one has affected the growth of my business	3.2***	5.7***	11.5***	4.0***
I feel the need to take legal advice more often than I did two years ago (or when the business first started trading if less than two years)	4.6***	10.2***	18.5***	6.3***
<b>N</b>	<b>7961</b>	<b>2151</b>	<b>416</b>	<b>10,528</b>
Base: All sample. The Table shows the percentages of respondents who 'Strongly Agreed' and 'Agreed' together for comparison.				
*** Percentages significantly different at 99%				
** Percentages significantly different at 95%				
* Percentages significantly different at 90%				

For larger and growing businesses in the sample (10-49 workers), there appears to be some supply issues: although overall, they reported it had been easy to find suitable legal services providers when needed, a minority (over one in 10) reported that not being able to find a suitable legal services provider had affected the growth of their business. Firms in the 10-49 size band were also more likely to report the need to take

on more legal advice than two years ago. These findings and the inference that there may be some different experiences amongst the small business population, are confirmed in the multivariate analysis. This further confirms the argument that it is firms that are undergoing new phases of development and growth that are more likely to experience problems, sometimes for the first time, and hence go through a process of identifying and engaging with legal services providers to help them tackle these new challenges.

This is obviously a learning process that will inevitably involve time and cost pressures as they seek out an appropriate adviser that they can trust and afford (see for example, Lowry and Chapman, 2000; Harris, 2000; Bennett and Robson, 2004). Certainly there is evidence that information asymmetries exist when business owners are seeking external assistance. This is particularly so when the selection and evaluation of advice is complex or the supplier has superior information (Gallouj, 1997) as has been identified in the selection of accountants (Gooderham et al., 2004).

## **8. Panel Analysis 2013-2015**

### **8.1 Background**

A subset of businesses participated in both the 2013 and 2015 surveys. Investigating these two subsamples provides some further insights into processes of stability and change in the experiences, practices and attitudes during the period. Such data contrasts with that provided by cross-sectional surveys of entirely different samples conducted at two points in time. With cross-sectional surveys, it is not always easy to determine whether any changes in experience, practice and attitudes derives from compositional differences between the two business samples, or from changes in behaviour by the same firms.

The overall survey is of individuals rather than businesses and it is important that the panel included only the same individuals who were still at the same businesses. Hence, three conditions are made to the sample in order to increase the likelihood that the data refer to the same firms in 2013 and 2015. First, that the respondent operated in the same detailed business sector in the two surveys; second, businesses that were public limited corporations (PLCs) in either 2013 or 2015 are excluded on the grounds they are not independently owned; and, third, that 2015 respondents must report being in business for at least two years. This resulted in a 'panel' sample of 1,407 businesses that have the same respondent, are working in the same detailed sector, their business is at least two years old and not a PLC. The data presented in this section is unweighted in order to treat the same business equally in both surveys. Because these data are unweighted, it is not possible to draw direct comparisons with the larger 2013 or 2015 survey samples.

### **8.2 Key characteristics of panel sample**

Table 8.1 shows the key characteristics of the panel sample in 2013 and 2015. As one might expect, the panel sample profile characteristics are similar across the two

surveys). The employment change variable shows that almost three quarters of the panel sample remained the same size in terms of workforce numbers. Among the remainder, slightly more respondents worked in firms lost staff rather than increased employment.

**Table 8.1 Panel Sample Characteristics 2013 and 2015 (unweighted)**

	2013 (%)	2015 (%)
<b>Business Size</b>		
1 worker	53.8	55.3
2- 9 workers	36.5	34.1
10-49 workers	9.7	10.6
<b>Ethnic Group</b>		
White British/other White	90.5	91.1
Ethnic minority/mixed	6.4	6.5
Prefer not to say	3.1	2.4
<b>Disability</b>		
Yes, limited a lot	2.8	3.1
Yes, limited a little	19.6	19.5
No	77.5	77.3
<b>Family Ownership</b>		
Majority owned by members of the same family	29.4	29.6
<b>Age of Business</b>		
Up to 3 years *	12.1	2.6
3-6 years	14.9	14.7
6-10 years	16.6	17.4
10-25 years **	37.2	43.4
25 years plus	19.3	21.9
No data	0.0	1.4
<b>Expected Turnover in Current Year</b>		
£1m +	5.6	5.7
£500k-£1m	4.5	4.5
£250-500k	6.7	6.8
£100-250k	8.8	10.2
£50-100k	14.8	14.2
Less than £50k	46.8	48.1
First year of trading	3.0	n/a
Don't know	9.7	10.5
<b>Expect to make a profit in current year</b>		
Yes **	68.4	73.2
No	16.1	12.8

Don't know	15.5	14.0
<b>Customer Base</b>		
Individuals only	34.6	34.8
Organisations only	40.8	40.4
Individuals and organisations	24.6	24.8
<b>Employment Change</b>		
No employment change	n/a	72.9
Employment decreased	n/a	14.6
Employment increased	n/a	12.4
<b>N</b>	<b>1,407</b>	<b>1,407</b>
Notes: (1) Family ownership question only asked of respondents who were not working alone. (2) Column categories do not sum to 100 due to rounding.		
Base: Individual respondents participating in both 2013 and 2015 surveys, operating in the same sectors and two or more years old at the time of the 2015 survey.		
** Percentages significantly different at 95%		
* Percentages significantly different at 90%		

### 8.3 Panel Sample Legal Capacity and Legal Problems

Table 8.2 suggests little change in panel sample firms' legal capacity. Most continue to operate without either a qualified or trained legal professional in-house or without retainer access to an external legal professional or and HR/employment specialist. Of those firms that do have access to legal expertise, only a small number possess *only* external capacity.

**Table 8.2 Panel Sample: Legal Capacity**

<i>Type of problem</i>	<i>2013 (%)</i>	<i>2015 (%)</i>
No legal capacity	85.5	84.4
Internal legal capacity only	4.1	4.9
Any external legal capacity (i.e. legal or HR/employment retainer)	10.4	10.7
<b>N</b>	<b>1,407</b>	<b>1,407</b>
Base: Individual respondents participating in both 2013 and 2015 surveys, operating in the same sectors and two or more years old at the time of the 2015 survey. Not statistically significant.		

The survey data suggest two key findings (Table 8.3). First, overall, panel sample businesses were more likely to report use of *any* business support services in 2013 than in 2015 (74% compared with 59%). This is quite a marked decline. It might reflect an increasing internal capacity to handle problems without external support, a decreasing number of problems experienced, or other reason(s).<sup>24</sup> Second, this pattern of decreased use is replicated across all of the 13 prompted sources, suggesting either a decreasing need or a decreasing willingness to use each of them. There appears to be no substitution effect as respondents switch their support-seeking activities from one source to another.

**Table 8.3 Panel Sample: Use of Business Support Services**

	2013 (%)	2015 (%)
<i>One or more external providers used in last 12 months</i> ***	74.1	58.9
Accountant ***	65.1	49.9
Solicitors' firm ***	21.5	11.5
Tax adviser ***	23.7	6.1
Financial adviser ***	21.2	8.2
Citizens Advice Bureau or similar independent advice agency	4.8	1.8
Other business support service *	11.8	2.4
HR/Employment service	6.7	3.9
A legal helpline	6.5	3.3
Debt collection/recovery service	4.1	1.8
Barrister	3.0	0.7
Patent/trademark attorney/agent	2.3	0.9
Licensed conveyancer	1.4	0.6
Another legal service	3.8	0.4
<b>N</b>	<b>1,407</b>	<b>1,407</b>
Note: In the 2013 survey, respondents were asked if they had contacted sources formally and informally; both are included. In 2015, the formal/informal distinction was dropped.		
Base: Individual respondents participating in both 2013 and 2015 surveys, operating in the same sectors and two or more years old at the time of the 2015 survey.		
*** Percentages Significantly different at 99%		

<sup>24</sup> It might also reflect, to some degree, a change in the question wording between the two surveys, removing reference to informal use. In the 2013 survey, respondents were asked to indicate whether they had used a service formally or informally. Formal means a paid for service; informal refers to advice or a service delivered by friends or family, for example.



\* Percentages significantly different at 90%

The survey data shows three key findings in relation to the specific types of problem (Table 8.4). First, for every problem type, the proportion of panel respondents reporting a problem was lower in 2015 than in 2013, from 34.5 to 28.% overall. There were two exceptions, regulation (relating to mandatory licensing, product safety, data protection and advertising standards) and debt/finance problems. Second, the rank order of particular types of problems were reported is broadly similar across the two surveys. Trading problems stand out in both years as most frequently cited but fell to 16.8% from 21.7% in 2013.

**Table 8.4 Panel Sample: Experience of Problems During the Past 12 Months**

<i>Type of problem</i>	<i>2013 (%)</i>	<i>2015 (%)</i>
<b>ANY PROBLEM REPORTED **</b>	<b>34.5</b>	<b>28.5</b>
Trading	21.7	16.8
Tax	6.0	4.3
Employee	8.0	6.4
Premises	5.4	4.5
Debt/finance	2.4	2.5
Intellectual property	3.3	2.4
Regulation	4.8	5.1
Structure	2.8	2.6
Other	1.6	1.3
<b>N</b>	<b>1,407</b>	<b>1,407</b>
Base: Individual respondents participating in both 2013 and 2015 surveys, operating in the same sectors and two or more years old at the time of the 2015 survey.		
** Percentages significantly different at 95%		

#### 8.4 Panel Sample Impact of Legal Problems

The panel sample's responses to the question regarding the outcome of the single problem they reported are shown in Table 8.5. Loss of income was the most commonly reported outcome. Slightly more respondents reported one or more of the prompted outcomes of their specified business problem in 2015 than in 2013 (49%,

compared to 41%). The profile of panel sample responses was broadly similar across the two surveys. One in 10 of those reporting a problem also reported additional costs as an outcome.

**Table 8.5 Panel Sample: Consequences of Most Recent Problem**

	<i>2013 (%)</i>	<i>2015 (%)</i>
ANY OF THE PROMPTED RESPONSES	41.4	48.6
Loss of income	19.1	25.6
Additional costs	11.1	9.5
Damage to reputation	7.2	7.9
Loss of customer/contract	5.3	7.7
Inability to complete scheduled work	7.2	7.4
Damage to relationship with another business	5.8	7.2
Inability to take on new work	2.9	6.4
Damage to property	1.9	1.5
Change in ownership/structure of the business	1.6	1.0
Loss of employees (other than through dismissal/ redundancy)	0.6	0.3
Had to cease trading	0.6	0.5
<b>N</b>	<b>486</b>	<b>391</b>
Note: Multi response. Different Ns due to different firms reporting problems in 2013 and 2015.		
Base: Individual respondents participating in both 2013 and 2015 surveys, operating in the same sectors and two or more years old at the time of the 2015 survey <i>and</i> reporting a problem in the past year. Not statistically significant		

Among the panel sample, estimates of the monetary value of losses incurred, as a consequence of the most recent problem reported, varied enormously. We caution readers that these figures are based on data from only a small number of cases; many did not provide an estimate. Outlier values from individual cases therefore influence the mean loss estimated in both years. A small number of outlier cases in 2013 reported much larger estimated losses (up to £3m); these skew the average (mean) estimates.

**Table 8.6 Panel Sample: Estimated Monetary Value of Most Recent Problem: Value by 25<sup>th</sup> Percentile**

	2013 (£)	2015 (£)
75th	10,000	8,500
50th	1000	2,000
25th	250	500
Mean	49,512	21,686
Median	1,000	2,000
<b>N</b>	<b>105</b>	<b>105</b>
Note: Monetary values rounded to nearest pound.		
Base: Individual respondents participating in both 2013 and 2015 surveys, operating in the same sectors and two or more years old at the time of the 2015 survey <i>and</i> reporting a problem in the last 12 months <i>and</i> providing an estimated monetary value of negative consequences.		

Among the panel sample reporting a problem, slightly more reported taking no action to sort out their most recent problem in 2015 (8%, compared with 6% in 2013) (Table 8.7) but a lower incidence of handling problems alone without external help (52%, compared with 60%).

**Table 8.7 Panel Sample: Which of these descriptions best indicate how your business went about sorting out the most recent problem?**

	2013	2015
No action	6.0	7.9
Entirely on its own	59.5	52.2
With help from an independent adviser/representative/ support service	17.9	18.9
An independent adviser/representative/support service sorted out the problem	9.9	11.0
With help from outside business friends/colleagues	8.6	9.5
Outside business friends/colleagues sorted out the problem	1.9	1.5
With help from family members~	-	1.8
Family members sorted out the problem~	-	1.5
Don't know	1.2	3.8
<b>N</b>	<b>486</b>	<b>391</b>
Note: Multi response.		
Two new response categories (indicated~) were added to the question in 2015 - with help from family members; family members sorted out the problem.		
Base: Individual respondents participating in both 2013 and 2015 surveys, operating in the same sectors and two or more years old at the time of the 2015 survey <i>and</i> reporting action to sort out a problem. Not statistically significant		

Turning to outcomes of the most recent problems, most panel sample business owners reported that the problem concluded in their favour (Table 8.8). Approximately, three quarters of the panel sample in 2013 and in 2015 reported favourable outcomes.

**Table 8.8 Panel Sample: Respondents' Perceptions of Outcomes**

	<i>2013 (%)</i>	<i>2015 (%)</i>
Completely in your favour	46.3	43.2
Mostly in your favour	29.8	29.5
Mostly not in your favour	7.0	7.3
Not at all in your favour	8.8	11.1
Don't know	8.1	9.0
<b>N</b>	<b>285</b>	<b>234</b>
Base: Individual respondents participating in both 2013 and 2015 surveys, operating in the same sectors and two or more years old at the time of the 2015 survey <i>and</i> reporting a problem in 2013 or 2015 <i>and</i> that the problem was now over or mostly over. Not statistically significant.		

## 8.5 Panel Sample Attitudes to Law

Respondents were asked the same attitudes questions in both the 2013 and 2015 surveys. The response profiles were reasonably similar for each across the two surveys (Table 8.9). Although the respondents were prepared to be more unequivocal in their answers in 2015. The panel sample were more likely to agree with the statement that law and regulation provide a fair environment for business to succeed in 2015 than in 2013 (42% agree or strongly agree, compared with 28% in 2013) and less likely to disagree (16% compared with 26% in 2013). This might reflect improved economic conditions, lower reported incidence of business problems, and / or an improved ability to handle business problems as a result of their longer trading experience.

**Table 8.9 Panel Sample: Attitudes to the Law**

'Law and regulation provide a fair environment for business to succeed'		
	2013 (%)	2015 (%)
Agree strongly	3.1	5.2
Agree ***	24.4	36.8
Neither agree nor disagree ***	42.2	33.5
Disagree	18.7	13.6
Disagree strongly	7.7	2.8
Don't know	3.8	8.1
'Lawyers provide a cost effective means to resolve legal issues'		
	2013 (%)	2015 (%)
Agree strongly	1.0	0.7
Agree	8.4	10.9
Neither agree nor disagree **	36.2	28.2
Disagree **	27.1	35.2
Disagree strongly *	21.9	16.0
Don't know	5.3	9.0
<b>N</b>	<b>1,407</b>	<b>1,407</b>
Base: Individual respondents participating in both 2013 and 2015 surveys, operating in the same sectors and two or more years old at the time of the 2015 survey.		
*** Percentages Significantly different at 99%		
** Percentages significantly different at 95%		
* Percentages significantly different at 90%		

The differences between those agreeing and those disagreeing with the statement 'Lawyers provide a cost effective means to resolve legal issues' remained very similar across the panel sample in 2013 and 2015, with 9% and 12% agreeing or agreeing strongly respectively. This is perhaps not surprising given the low levels of use of legal professionals across the sample. Disagreement may be based as much on perceptions of likely cost and quality than it is on actual experience.

## 8.6 Summary of Panel Sample Comparisons

The limited change evident in the data from the panel sample is perhaps not too surprising for several reasons. First, the time period between the two surveys is insufficient to allow meaningful time-series exploration and, in the absence of any huge shock emanating from the wider economic, political or social environment, firms' behaviour may exhibit stability rather than change. Second, the similar empirical data patterns reported provide increased confidence in the picture they offer of small firms' experiences, practices and attitudes to legal services. We may have greater confidence in *two* surveys reporting similar data than in a single survey. Third, as discussed at various points in this report, the 2013-15 period was one of improving business conditions in the UK, much improved on the turbulence and uncertainty of the financial crisis period and the accompanying recession. Many (surviving) businesses are performing better in terms of sales and profits than in previous years and business confidence is at a high point relative to recent times.

What survey data do not capture very well are the processes underlying the data patterns found and the reasons why they are so and not otherwise. Similar patterns may be held together by quite divergent environmental pressures and incentives and/or business owners' changing definitions of 'business problems' or a changing willingness and capacity to take action to solve those problems, including a recourse to legal professionals. While the incidence of reported problems has fallen for the panel sample businesses, we cannot say too much about whether business owners' definitions of problems have changed, or whether the business world in which they operate has generally become more amenable to them.

## **9. Conclusions and Implications**

### **9.1 Introduction**

This report has presented new evidence on small business' experiences of legal problems and their strategies and actions to deal with these problems. Specifically, the analysis asks: what are small business owners' attitudes, use and experiences of accessing the legal system when addressing business problems? As well as drawing upon the wider literature on small firms' use of external services, the report builds upon previous research undertaken for the LSB (Pleasance and Balmer, 2013) which provides a useful benchmark for comparison. What have been the changes since the 2013 study?

The analysis is set within an economic and legal environment that is undergoing substantial changes. First, the significance and growing importance of small firms to the economy in terms of employment, output and innovation is widely acknowledged: 99% of the 5.2 million private sector enterprises in the UK in 2014 employed less than 50 people. This business population is also changing towards zero-employee businesses (BIS, 2014a) as well as home based businesses (BIS 2015b; Mason and Reuschke 2015;). Second, it is also recognised that small firms operate in a regulated environment and are immersed in a sea of Law (Edelman and Suchman, 1997) with implications for internal (eg. employment) and external activities (eg. trading). Hence, this report has sought to analyse some of the problems that small firms face in the production of goods and services and how they seek to address them. The study has focused on those problems that are 'justiciable', or in other words those that could potentially be resolved through legal process.

Research on small firms' use of legal services is relatively scarce compared with that on their engagement with other service providers, such as public agencies or accountants. Hence, the findings of this research add to a developing body of evidence that seeks to understand how small firms engage with the legal service providers.

This section first discusses the key findings, identifying the main patterns and distinctive results with reference to the earlier results, set within the broader

literatures. The following section discusses the importance of trust and the role of legal services within the broader context of small firms' use of advice services. Finally, implications for the legal system and how access to justice for small firms may be developed will be considered.

## 9.2 Key findings

### 9.2.1 *Low Use of Legal Services*

Overall, small firms' use of legal services is low: fewer than 5% employed a legal professional (or person with legal training) in-house and 8.5% had a retainer with a legal services provider. Compared with 2013, there was an indication that accessing of legal services had declined. This may have been a result of the upturn in the economy particularly given the argument that the demand for legal services is triggered by a specific need, rather than a result of a planned strategy. It may also have been a result of the perceived rising costs of accessing legal services.

### 9.2.2 *Distinctiveness of Legal Problem Capacity and Problems: Making the Link*

The analysis revealed a number of distinctive characteristics of those firms with legal capacity. Holding other factors constant, larger firms, those that are BME owned, and those owned by someone with a severe reported disability were more likely to have internal and external legal capacity (Figures 2.2 and 2.3). There was also a positive statistical relationship between having legal problems and size of firm. These findings confirm the findings from the 2013 survey. The experience of having a legal problem, to some extent, helps to explain the reason for small firms accessing legal services and developing legal capacity. The analysis also found specific employment size thresholds up to which firms seek to develop additional legal capacity: for external capacity this was estimated to be 29 employees and for internal capacity this was 37 employees. These points relate to marginal changes and not absolutes and should not be taken to indicate a reduction in legal capacity. Rather these thresholds indicate a slowing down in additions to legal capacity. This is to be expected, since the requirement to have an internal specialist and the ability to afford one appears to be associated with business



size. The points may also be taken to infer when firms are most susceptible to taking on additional legal capacity and thus seeking engagement with the legal services.

Overall, the average number of legal problems reported fell between 2013 and 2015, confirming a more benign economic environment from the earlier recessionary period. 'Trading' followed by 'taxation' and 'employees' were the most frequently cited origin of legal problems.

A detailed analysis of firms' characteristics shows that BME-owned firms and respondents with a disability were more likely to report having legal problems. Larger firms and those expecting a financial loss were also more likely to experience problems. With the exception of those experiencing a loss, firms with these characteristics were also more likely to have legal capacity. Hence, it is no surprise that there is a positive statistical association between having a legal problem and the existence of internal and external capacity (Figure 3.1).

The analysis estimates that certain business problems are at their highest at specific employment size points: for example, for 'trading' this is estimated to be 27 employees, for 'intellectual property' this is at 46 employees. From this it may be deduced that, in general, the demand for specific types of legal services will vary by size of firm and certain services will be required earlier on as the business grows. What we cannot establish at this stage, however, is whether the demand for legal services is being fully met or constrained by other factors; this issue is discussed further in section 9.3.

### 9.2.3 *Impact of Legal Problems*

Of those firms that reported a legal problem, around half reported an impact, an increase on 2013. The most frequent reported impact was the loss of income, reported by a quarter of those reporting a problem, followed by loss of customers, additional costs and inability to complete work. The analysis showed an association between the existence of legal capacity, existence of a legal problem and impact. As well as having a greater likelihood of having legal capacity and experience of a

problem, BME owned firms and respondents reporting a disability were also more likely to report an impact of a problem on their business (See Figure 4.1).

The above emerging pattern is not, however, straightforward in relation to the impact of legal problems. Despite reporting fewer legal problems and lower levels of capacity, firms with one worker were more likely to report an impact on their business than larger small firms. This departure in the case of very small firms from the general observation that legal problems stimulate access to legal services and capacity to tackle legal problems is important. It suggests a distinctive size effect: very small firms are not accessing legal services and as a result are not resolving their problems satisfactorily. As a result, it may be argued that there is not so much an unmet legal demand issue but rather a potential issue regarding the reluctance of very small firms to engage with the legal profession. This is all the more significant when it is considered that very small firms were less likely to report a legal problem in the first place while the economy shifts further towards micro and one-person firms.

### 9.3 Small Firms and Engagement with External Services: the role of trust

Given the relative internal resource scarcity of small firms compared with larger enterprises, there is often an assumption that owner-managers readily draw upon external advice and support services from public and private providers. Certainly, the absence of in-house expertise and / or capacity to deal with specific business problems may provide a stimulus for engagement with external providers. However, the literature suggests that this may not be the case and small business owners use external services only when they have exhausted in-house and informal sources of advice and support (Bennett and Robson, 2004). Indeed, the weight of the evidence suggests that small firms use their accountants more frequently than any other provider and this is on the basis that it is a necessary relationship for taxation and compliance purposes and set within an 'institutional' trust framework (Blackburn et al., 2004). However, the research also suggests that the development of 'relational' trust is a crucial part of the external advice seeking process. Specifically, small business owners and their advisers require interaction and information exchange, particularly in order to convince the business owner that the adviser is appropriate and can deliver

the advice required. In doing so, previous relations as well as recommendations from trusted parties where no prior experience is present, will be important for the small business owner. Private sector suppliers, such as providers of legal services, accountants and banks, benefit from having a relatively strong institutional trust because of their regulatory structures and codes of practice.

The above context is important when seeking to understand small firms' use of legal services and their attitudes to legal services. The analysis in this report, and that in the 2013 study for the LSB, found a low use of legal services: 87% of firms had no legal capacity, whether in-house or via external retainer. Furthermore over half of firms that reported a recent problem sorted this out 'on their own' (Table 5.1). Those going it alone also showed distinctive characteristics. Again firms that were BME-owned, respondents reporting a disability and larger small firms were less likely to solve the problem alone. One-person enterprises and family owned firms were more likely to solve the problem alone.

These findings may be a result of a number of factors. First, firms may not require a legal service for resolving the business problem, perceived or otherwise. These problems may not necessarily be justiciable or require legal advice. Second, small firms may require a legal service but for some reason, they may be deterred from accessing the legal system. Many business owners will not have used a legal service previously for their business and so knowing who to approach may be a problem. Certainly, they perceive lawyers as expensive and they are not part of their trusted relational networks. Some firms may not wish to utilise a legal service for fear of loss of reputation within the industry and the loss of future work, especially if they are considered litigious by prospective clients. Finally, owner managers may have worked out 'coping' strategies by sorting out their problems informally and through other networks. For example, family firms have been shown to use their extensive network capabilities to solve problems and access resources. In other words, using a legal service is not considered an option unless all other previously trusted sources of advice have been exhausted.

However, given the ostensible ‘institutional’ trust that the legal profession has, the low use of legal services reported in this study may be considered surprising and may indicate unmet legal need: almost 20% disagreed with the statement that *it is easy to find a suitable legal services provider that I can afford*. Further, almost a third ‘neither agreed nor disagreed’ and a quarter ‘did not know’. This is consistent with the view that although institutional trust is embedded in the legal profession, it is not sufficient for small business owners to access lawyers more frequently. Indeed, the finding that they access lawyers as a last resort to solve business problems underlines this point.

These findings are underlined when very small firms are examined. Throughout the analysis, firms with one worker showed a much lower level of engagement with legal services and were more likely to report negative attitudes regarding lawyers in terms of their cost and access (Table 7.7). Although it may be argued that such views are based on perception rather than experience, this nevertheless presents a challenge for legal service providers. Very small firms were also less likely to feel a need for legal services, despite being more likely to report a negative impact of a legal problem on their business.

This analysis leads to the conclusion that most small business owners do not regard lawyers as part of their natural business problem resolution strategies and are not accessing legal services because of perceived and real barriers. In contrast, accountants benefit from both institutional and relational trust because of the frequency of contact and a greater understanding amongst firms of what accountants provide. How the gap between small firms’ legal needs and their access to legal services via lawyers can be bridged will be discussed in the final section. Certainly, this involves addressing perceived barriers as well as accessibility and costs.

## 9.4 Implications

In the view of the researchers, the analysis suggests a number of implications for both the legal profession and small business owners.

First, there needs to be *greater clarity of the services* offered by the legal profession to small firms. As a starting point, it has to be recognised that the small business population is not homogeneous and may require some segmentation. In particular, the analysis has identified differences in access to legal services according to size of enterprise. It appears that one-person and micro firms have lower levels of engagement with the legal profession and have poorer impressions of the profession than larger small firms. Whilst it may be the case that some very small firms may be able to address business problems effectively themselves, the analysis has shown that the impact of legal problems is relatively high. This is particularly important given the shift towards one-person and micro firms in the past decade. Of course, reaching one-person and micro firms is challenging. This report has found the micro-segment of the small business population to be very reluctant to take up legal advice in its current form. Other business segmentation approaches by legal service providers may include targeted services for business start-ups, firms with owners of differing ethnic minority origin and those run by owners with a disability, or specific sector offerings where these are relevant.

Second, those organisations providing legal services to small firms need to be more proactive and *communicate their offerings* much more effectively if access to the legal system is to be improved. One of the key barriers to small firms' engagement with legal services appears to be that they are used as a last resort and are not part of small firms' formal and informal networks. Hence, for many small business owners, they remain unknown and distant. Although lawyers may have an advantage of possessing institutional trust, if they are to develop relations with small firms this requires building upon this with relational trust. Whilst advertising events within legal professional circles and raising awareness amongst lawyers may be a step in the right direction, they need a greater presence to inform small firms of their services and costs.

Third, and related to the above, given that small firms mainly rely on recommendations when looking for an external service in the first instance, the *legal profession needs to make stronger strategic ties with other key business support providers*. This will involve the legal profession strengthening ties with other intermediaries which small firms frequent. It will ensure that they are an embedded part of the support network. For example, working with accountants, national agencies, local authorities, trade bodies and chambers of commerce may help put legal services providers on the 'map' and enhance a network of contacts. This adds weight to the need for legal services providers to be innovative and underpins the notion of promoting multidisciplinary service providers (ERC, 2015). There is also a national and regional element to this approach. Given the plethora of small business initiatives by government to promote for example growth, innovation and exports, building in a legal component would help break down the barriers between small firms and legal providers. Hence, gaining the trust of other business support providers may provide a key to overcoming the barriers that exist between legal services providers and those small firms needing their services.

Fourth, small business owner-managers would also benefit from their own *representative organisations raising the importance and potential contribution of legal services* to help them set up their business, develop it and enhance their business performance. The main lobby and representative groups tend to focus on raising issues such as the high cost of legal services (although some membership organisations are involved in service provision, such as the Federation of Small Businesses). However, the take up of legal retainers in the sample in this study was not particularly high and does not address the growing micro-firm market. Raising awareness of legal services available to very small firms may be a role for small business representative groups.

Fifth, it may be argued that *legal professionals would benefit from closer ties with small business owners through education and educational institutions*. Business schools are being promoted as hubs of support for small firms, both in terms of placing students in small firms and providing development programmes for small firms

themselves (See BIS, 2013; and Small Business Charter).<sup>25</sup> There is a potential role for legal services to be an integral component of such initiatives and reach small firms but so far this appears to be a missed opportunity. This would help legal services professionals understand the challenges of running a small business and the need to show that they can help small businesses create value and be more efficient. However, a higher profile within business schools would help legal professionals understand more about some of the concepts used in business and economics studies, such as transaction costs and information asymmetries, and thus help shape their offerings to small businesses. As many smaller practices in the legal profession encounter such challenges themselves, either as self-employed individuals or partnerships, the trust gap identified in the report may not be as wide as perceived.

Finally, given the image amongst many business owners of lawyers as expensive and irrelevant to solving business problems, there needs to be a *strong communications initiative at the level of the legal profession and with small business groups as a whole*. This should be designed to break down the information barriers between lawyers and small business owners. It may be important for example, to portray lawyers as helping anticipate and thus avoid legal problems rather than being advisers of last resort. Of course, this would involve investment by larger law firms and the involvement of small business groups: chambers of commerce, enterprise agencies, trade and professional bodies. Moreover, if government seeks to promote entrepreneurship in the economy, this should be underpinned with support for a legal system that meets the needs of small firms.

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<sup>25</sup> See for example, the Small Business Charter. <http://smallbusinesscharter.org/>

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